The balancing act of People Performance Management

Research report on the effectiveness of People Performance Management

EY

Building a better working world

Contents

Executive summary

Organizations tried to improve their People Performance Management (PPM) system several times in the last century. From time to time, the focus shifted between a "control" purpose – resulting from scientific management theories as well as an emphasis on targets and KPIs – and a "development" purpose. The latter originated from motivational theories that were developed in the 1950s.

In the world of sports, there seems to be a natural balance between control and development. Athletes have frequent conversations with their coach, trainer and/or team to keep improving their skills. Here, feedback and KPIs are used as means to measure progress rather than to ultimately appraise the athletes. For most athletes, the continuous improvement and development of their skills – and not the golden medal – is their reward. We found that athletes generally have a strong intrinsic motivation. This enables them to dedicate a big part of their life to reaching the top. We think that our organization and individual performance could greatly benefit from the application of these lessons.

Currently, many PPM systems focus on the development of employees. This leads to changes that include the removal of ratings and/or rankings as part of the appraisal and an increased focus on development in more frequent conversations. Since salary increases and/or bonuses were usually connected to ratings, the link between performance and financial reward is becoming increasingly vague. Even though different theories support these interventions, managers and employees are still frustrated with the system, while its effectiveness is debatable.

This seems to be caused by the fact that organizations view the "control" and "development" purposes as a mutually exclusive choice, when they should rather focus on striking a balance between organizational and individual needs. This can be the concept of Performance Activation: instead of calling it People Performance Management, which implies that employees need to be "managed," the term Performance Activation highlights the empowerment of the employee. The framework details a balance between the organizational (control) and individual (development) needs within people performance. In order to make the step toward Performance Activation, all elements of people performance should be aligned and balanced between organizational and individual needs.
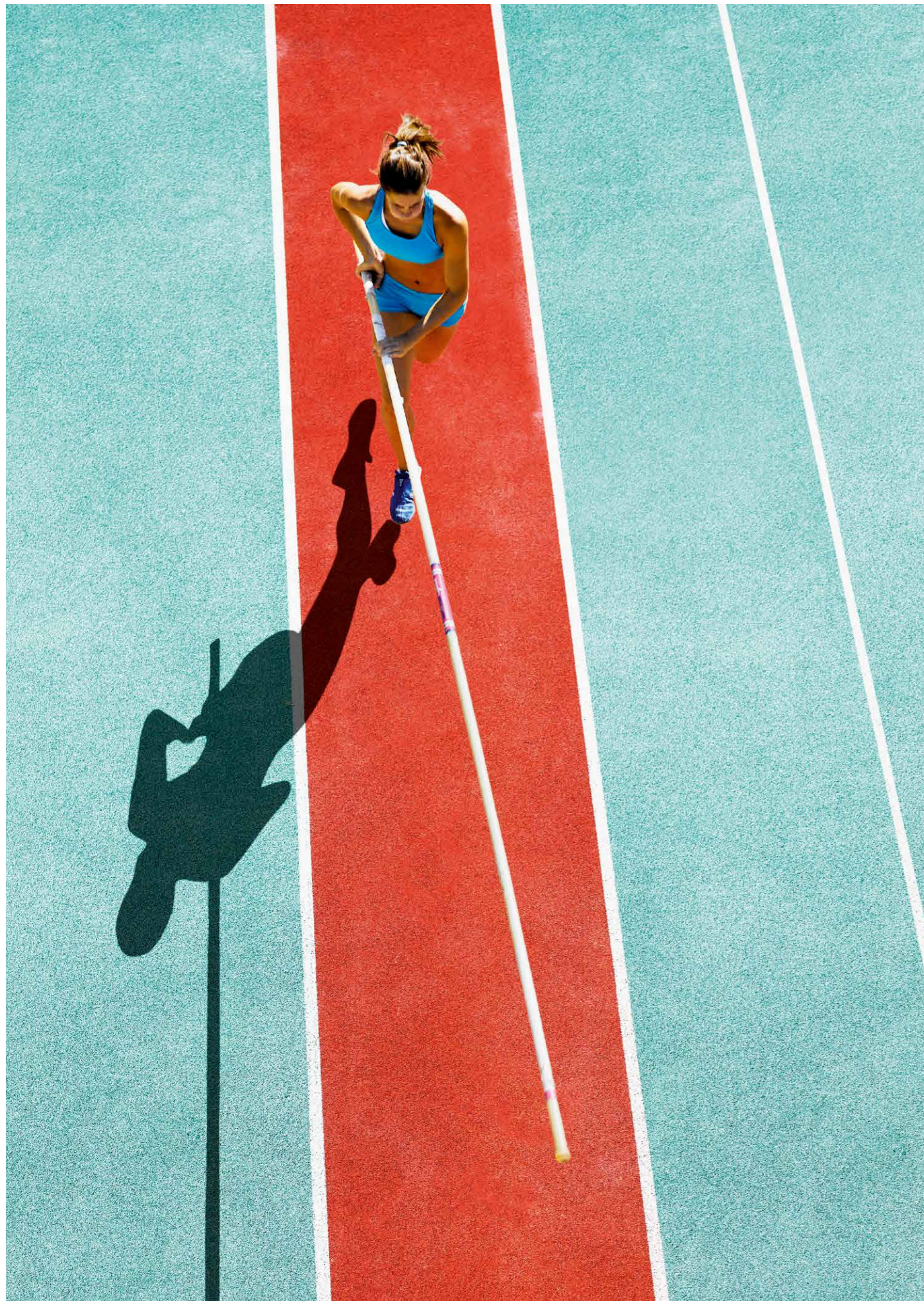
1. Introduction

People Performance Management (PPM) is not a new topic for organizations or for organizational science. Neuroscientists, business consultants, psychologists and management gurus have discussed and dealt with this topic for more than a century.

There is a variety of definitions of PPM and many people equate performance management with performance appraisal. This is a common misconception, as performance appraisal is just a part of PPM. PPM is often described as the combination of tools, processes and programs that organizations create or apply to manage the performance of their employees; or, as "the godfather of PPM" Aubrey Daniels defines it: *"PPM is a way of getting people to do what you want them to do, and to like doing it."*

1.1. Effectiveness of PPM debated

In recent years, PPM has become a highly important topic of conversation for many organizations and their boards. They have realized that PPM is seen as a must because they have always done it and everyone does it, but it seems hardly possible to execute PPM effectively and the results are questionable. This makes it in many cases mainly a ritual dance, repetitive and a "must."

> **"**
> Bureaucracy, nonsense. It is common law. Abolish it. I have never seen that it substantially contributed to changing the culture.
>
> *Manager*

Some critics argue that PPM is a complex and expensive instrument to make people unhappy. Therefore, many organizations have redesigned their PPM process. Changes vary from dropping ratings and having more frequent conversations around development to cutting the link between performance and rewards.

> **"**
> PPM was a job for a very large group of managers within our organization. Scorecard managers I call them.
>
> *Employee*

Despite all these changes, a CEB[1] study in 2016 confirms that Performance Management Systems are still failing. Only 4% of HR leaders feel that they are effective at accurately assessing employee performance. Initial positive responses after dropping performance ratings tend to fade and expected performance improvements are not realized. A study conducted by the NeuroLeadership Institute in 2015 found more positive responses (which can also be explained by the fact that organizations are more likely to discuss positive experiences than negative ones), but it also observed that organizations encountered several big challenges.

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1 CEB is a global best practice insights and technology company that was acquired by global research firm Gartner in 2017.

1.2. Realization of this report

With this research report, we aim to clarify the context why PPM is not working as effectively as it could and provide insights into the drivers that make PPM effective. In order to do so, we:
- ▶ Conducted a comprehensive literature review and combined this with field research in the area of performance management
- ▶ Interviewed 34 managers, employees and HR representatives at 7 different organizations and industries (automotive, financial, technology, government, business services and beauty industry), varying in size from a start-up and a municipality to a corporate tech organization

We also found inspiration in the world of sports. Apart from many differences, there are interesting similarities between the world of business and the world of sports. Elements such as motivation, goal setting, development and feedback, formulating strategies to win, and dealing with success and failure all apply in both worlds. As Teun de Nooijer, former professional field hockey player and current coach of Bloemendaal's top women's field hockey team, perfectly put into words[2]: *"Of course, not everything is exactly the same in sports and in business, but many processes are. A sports team is a group of people who want to achieve something together; this is no different for teams in the world of business."*

Therefore, we interviewed current and former top athletes and coaches in order to gather interesting insights as well as lessons learned that can be applied in the corporate world to improve PPM processes and, ultimately, organizational performance.

In this report, we will first dive deeper into the concept of PPM. We will start with a historical overview and explain what changed in the world of PPM over the last 100 years. We will see that the focus shifted over time from performance control to the development of people – and back. Currently, many companies are focusing on the development side of PMM. This "choice" has generally been viewed as an "either/or" scenario, in practice and in literature. So far, however, this has not lead to desirable results. Next, we will share the lessons learned from the world of sports. We will then take a look at current PPM systems and interventions in different elements that many organizations have implemented to explore why these interventions do not always have the intended effect. Subsequently, we introduce the concept of "Performance Activation". Our point of view is that both organizational (control) and individual (development) needs should be met in order to effectively manage performance over time. Finally, we will provide conclusions and recommendations to increase the effectiveness of PPM for your organization.

2. People Performance Management: An overview

In this chapter, we will discuss what the historical developments in PPM are and what triggered them. We will see that there was a constant shift over the last century in the focus of PPM on either "control" or "development." Many articles have been written explaining that systems with a dual purpose of performance control on the one hand and the development of people on the other cannot be effective. This resulted in organizations choosing one purpose over the other and changing only a few elements of the entire PPM system. In Chapter 5, we will elaborate our point of view that it is not so much an either/or decision on control and development, but rather that it is important to strike a balance between all the relevant elements of PPM.

2.1. Historical overview of People Performance Management: From control to development

The recent changes that many PPM processes are undergoing have not been the first. Cappelli and Tavis (2016) provide an historical overview of the developments in performance management in the 20th and 21st century, during which there was a constant shift in the focus of PPM, moving from "control" (which the authors call "accountability") to "development." They trace the origins of appraisals to a merit-rating and -ranking system created by the U.S. military around the time that WWI took place, aimed at identifying poor performers for discharge or transfer and high performers for promotion to officer roles. In the following years, most organizations were using appraisals as a means to document performance and as a basis for rewards decisions.

2 "Topsporters in het bedrijfsleven: Teun de Nooijer", www.mt.nl, August 2018.

8 | The balancing act of People Performance Management

The balancing act of People Performance Management | 9

Control-based PPM systems are often deeply rooted in conventional scientific management theories (Fayol, Taylor and Drucker). Drucker's Management By Objectives (MBO), a top-to-bottom approach that seeks to control, coordinate and motivate managers and employees, is hailed as "one of the rational school of management's most successful products." The underlying assumption of this management approach is that employees can be motivated by *carrots and sticks*: people can be controlled and directed toward achieving organizational objectives by means of reward.

Critics maintain that MBO is difficult to implement and that organizations often wind up overemphasizing control as opposed to fostering creativity in order to meet their goals. Peters & Waterman argue in their *In Search of Excellence* that with the increasing complexity and multiple competing demands, organizations simply cannot handle decision-making in a totally rational way. They say that we rely too much on fixed scientific management principles which are based on the principles of reinforcement, whereas the environment requires much more agility, self-organization and flexibility. As a result, they claim that rational systems are inherently self-defeating in the long run.
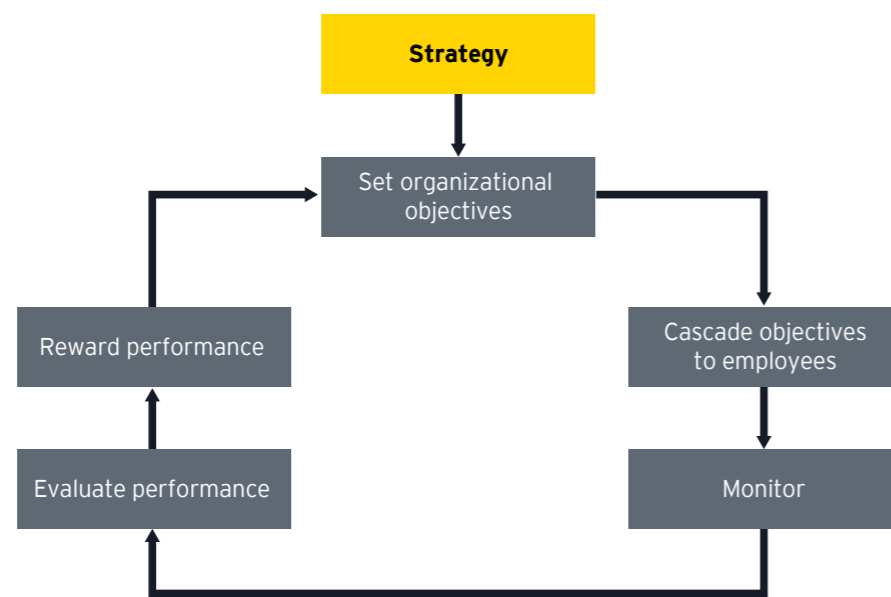

Figure 1: Peter Drucker's Management By Objectives, often the foundation for control-based PPM systems

In the 1950s, Douglas McGregor developed his point of view on the "Theory X" and "Theory Y" approach to management. Theory X is based on the assumption that people are motivated by extrinsic motivators such as punishment and material rewards. By contrast, Theory Y is based on the assumption that people have an intrinsic motivation to perform well and just need good support to do so. Theory X worked well in the early 20th century because it enabled great efficiency in manual labor and assembly line performance. However, Theory X does not work well for jobs in which the nature of work demands more creativity and complex problem-solving skills. Therefore, organizations started to focus their PPM efforts on the development of their employees' talents. Daniel Pink translated these theories into behaviors in his widely published book *Drive*: Type X behavior, resulting from Theory X, and Type I behavior, resulting from Theory Y. In order to intrinsically motivate people and stimulate Type I behavior, organizations need to focus on autonomy, mastery and purpose.

In the late 1960s, this focus started to shift back to control when the view arose that tracking performance did not get the attention which it should. Managers were reluctant to differentiate between good and bad performers. At that time, organizations started to separate the conversations around control and development because of their conflicting interests.

From 1970, inflation rates shot up and the pressure increased to award pay more objectively, resulting in a shift back to control. This led to the introduction of the forced ranking system at General Electric by Jack Welch in 1980, which he based on the military system used in WWII. He divided his workforce into A, B and C players, where development efforts should only be directed at A players. In the 1990s, the view emerged that some employees were simply more talented than others. As these talents were in short supply, they should receive extra attention and rewards. Furthermore, it was assumed that the personality traits resulting in superior performance were fixed.

2.2. What good does control do?

In the early 2000s, a focus on motivating and managing employees through control was still the main way in which organizations used PPM. This included the use of ratings and forced rankings. The development goals of PPM were increasingly difficult to achieve due to the flattening structure of many organizations, which resulted in an increased number of direct reports for managers. McGregor argued in his "Theory Y" approach that in order to motivate employees, managers need to invest a significant amount of time in the development of their employees. However, with an increasing number of direct reports, the time spent per employee in fact decreased. Additionally, organizations increasingly hired employees externally, decreasing the need to focus primarily on internal development.

Organizations started to question what good the internal comparison by rating and ranking employees was doing for their organization, especially since it seemed to result in a very competitive organizational culture that hindered cooperation between employees. This became an even bigger issue when dealing with increasingly complex business challenges.

One of the organizations that we interviewed moved away from rankings and ratings to shift the traditional inward focus more outward. Their traditional idea was: "We are the best, there is no real competition outside the walls of our organization, so we should compete internally." However, they realized that competition increasingly came from outside the company. A culture of teamwork and innovation was required to compete with other organizations instead of with their own colleagues. The removal of ratings and rankings enabled them to work toward this desired culture.

> " In my organization, a stack ranking model was used. This led you to focus on your colleagues, comparing performance and strong competition. As long as I was on the right side, I just ignored the model. It is a way of controlling: 'if you do not do what we want … ' That harms my trust in the organization because it makes it seem that the organization does not trust you.
>
> *Employee*

The greater need for teamwork that arose in organizations also led to other issues. The top three issues that we uncovered were:
▸ Goals and rewards were often based on individuals instead of teams
▸ The rise in complexity and the rapidly changing environment made it harder to set annual goals – often, the goals set at the beginning of the year lost their meaning as the year progressed
▸ Both employees and managers severely disliked the PPM process – as mentioned earlier, it was seen as a time-intensive and expensive way to make people unhappy

A complete list of the limitations of standard PPM processes applied in organizations is included in Table 1 below, together with potential solutions.

Commonly cited limitations of traditional performance management:	Organizations seek solutions that enable:
▸ **Slow and cumbersome process,** resulting in waste of costly organizational resources without clear benefits ▸ **Misaligned** to the values, motives, needs and personality of the individual ▸ **Backward-looking** instead of forward-looking, with a focus on monitoring past achievements instead of enhancing performance by looking at future ones ▸ Focused on **output** rather than value drivers ▸ **Limited in supporting** employee engagement and performance due to the emphasis on end-point reviews rather than regular and real-time feedback and coaching ▸ Current PPM process **not flexible enough** to respond to changing business and/or cultural realities ▸ **Unaccommodating of today's employee-employer relationship,** where employees expect a far greater degree of autonomy and flexibility in their work	▸ A much more **effective PPM process** and system based on **a clear PPM strategy** ▸ Greater focus on **intrinsic motivation** ▸ Discussion of an **individual's contribution** and **development** instead of a focus on ratings and rankings ▸ A much greater degree of **coaching on input and process** rather than directive management on KPIs and output ▸ **More frequent conversations** to ensure just-in-time check-ins and performance feedback rather than a directive annual process ▸ **More agile approach in key PPM activities:** goalsetting, managing and coaching, evaluating performance, and rewarding and recognizing ▸ **More employee autonomy and self-management**

Table 1: EY market insights into PPM practices (2018)

In sum, the history of PPM has experienced several shifts: from a focus on more control to development and back to control again. Additionally, different theories on the development of employees arose. Next, we will explore the most recent changes that organizations implemented and that demonstrate the current focus on development.

2.3. What has changed in the world of People Performance Management?

In order to deal with the aforementioned limitations, organizations implemented several changes to their PPM systems over the last five years. The most common interventions are discussed below.

2.3.1. Focus on development
The focus of many PPM systems has again moved from control to development. Instead of having an annual PPM cycle, most organizations that we interviewed now have more frequent and more informal conversations around development and future growth. In addition, we found that feedback from managers or peers and direct reports are becoming increasingly important in the PPM process.

2.3.2. Different approaches toward appraisals
We see different approaches to appraisals, ranging from dropping ratings and rankings to less focus on KPIs and dropping appraisals altogether. Additionally, we spoke to different organizations who still use ratings as part of the annual appraisal because they are at the start of redesigning their process or simply because they have no good alternative. They choose to keep the ratings because they feel that it will be difficult to recognize people's performance without them and that it could potentially be perceived as unfair. This will be further elaborated on in Chapter 4.

> An **appraisal** is a formal way of assessing an employee's performance over a particular period of time.
> A **rating** is the grading of an employaee on a numerical scale that an annual raise or bonus used to be based on.
> **Rankings** are intended to evaluate employees by comparing them with all of the other employees in similar positions within the company.

2.3.3. Weaker link between performance and financial rewards
Traditionally, compensation decisions were based on performance appraisal outcomes, e.g. through the use of merit increases and/or bonuses, depending on ratings and rankings. If organizations do not have an annual appraisal, they do not have ratings and rankings to base compensation decisions on. This means that managers have greater freedom to differentiate rewards, based on other factors than just one's rating. Consequently, managers need to take more responsibility for differentiated appraisals and rewards, which seems to be a daunting task for some managers.

2.4. The paradox of control and development

Many of the interventions described above stem from good intentions, and will in theory increase motivation and hence organizational performance. However, many recent studies have found that there still is a lot of unhappiness and frustration around PPM (CEB, 2016; Cappelli & Tavis, 2018). This was confirmed in our interviews. In Chapter 4, we will discuss the causes of these frustrations in greater detail, but we believe that there is another overarching cause of these frustrations that we want to address first.

As we have seen in the first part of this chapter, the issue with PPM that organizations have addressed over the years revolves around the control versus development purpose. They tried to combine the two purposes in one process but emphasized one over the other. Some studies argue that it is not feasible to create effective PPM when it has a dual purpose (MacFarlane & Hosseini, 2014; Chubb, Reilly, Brown, 2011) due to the unworkable tension which it creates.

> " Perhaps steering based on results and developing people at the same time is difficult to combine. I want to appraise someone on a job well done, not on utilization.
> *Manager*

However, if you focus solely on development, the question is how you can link individual performance to organizational performance. How do you make reward decisions that are perceived as fair? This is something that we know to be crucial in employee satisfaction with reward decisions (Coen & Jenkins, 2002). Several interviewees of organizations where ratings or appraisals were dropped were generally skeptical and sometimes even frustrated about their financial compensation, since it was not clear how those decisions were reached.

> " The difficulty lies in the growth in salary scales. Ultimately people want to see a little bit of appreciation in money. Employees are unsure about how this will work when we no longer have any ratings.
> *Manager*

This finding is confirmed by studies like the research done by CEB in 2016. Another question is how you know where you stand if you do not receive an appraisal of your performance. Therefore, some organizations chose to keep ratings as part of the PPM system. One of those organizations is Facebook, where they decided to keep the ratings in order to increase fairness and transparency, according to an article in *HBR* (Goler, Gale, Grant, 2016).

When PPM is used to "control" and inform decisions on rewards and promotions, though, how do you foster employee development and growth? When people know that they will receive a score at the end of the year that reflects their performance and that will impact their salary, how can we expect them to be open and transparent about what they still need to learn? This seems like a paradox: an organization needs both control and development, but most have so far failed to have them at the same time.

In addition, it seems to be difficult to implement successful PPM practices. Through our interviews, we learned that many organizations implemented more frequent conversations around development but did not specifically train their leaders in how to do this. They also did not or not yet consider whether their ways of working and their culture needed to change in order to support this new approach, or they wanted to create High Performing Teams but still evaluated and rewarded the employees on an individual basis. To gather insights into this from a different perspective, we interviewed current and former athletes and coaches. The findings are presented in the next chapter.

Control / Development

Control	Development
Manager providing feedback / Cascaded organizational objectives	Self-initiated/ individual objectives / Frequent conversations
Main goal: Decision-making	**Main goal: Growth**
Manage employees / Rating/ ranking / Annual/bi-annual conversations	No rating/ ranking / Coach employees / 360° feedback

Figure 2: The control and development paradox

3. What can organizations learn from sports?

In order to learn more about performance management in the world of sports and determine what organizations can learn from it, we interviewed eight athletes and coaches from different team and individual sports. We will discuss the most relevant insights here.
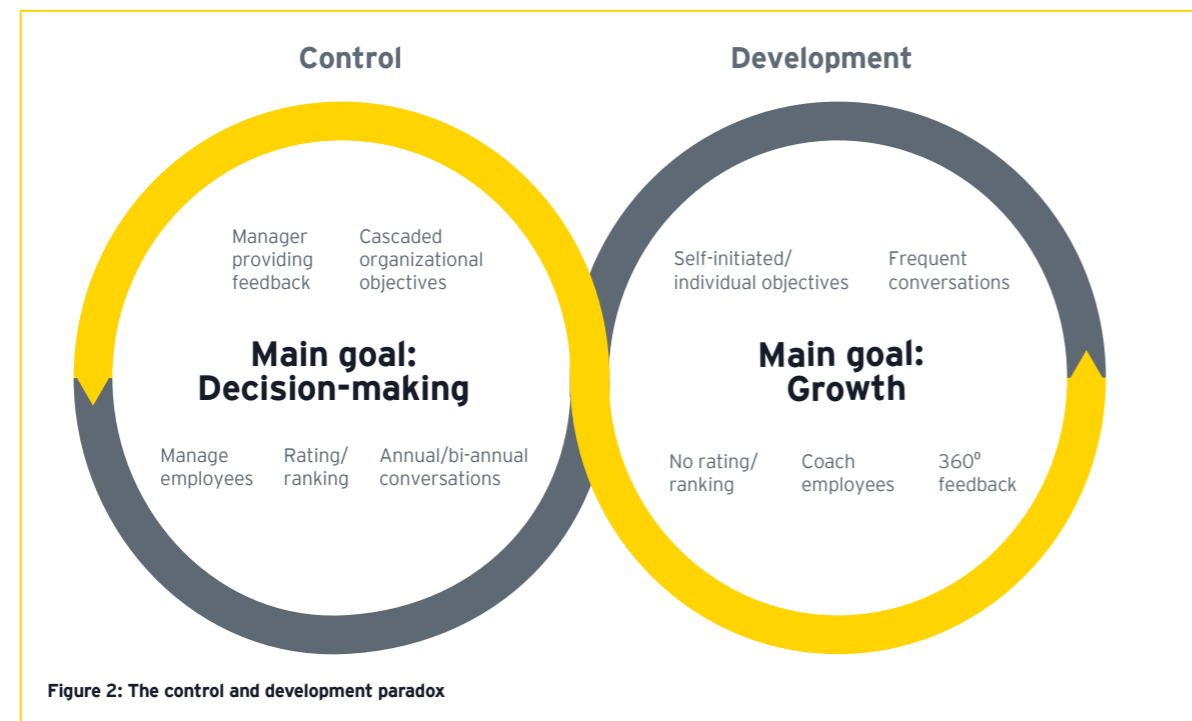
3.1. Driven by intrinsic motivation

The first thing that stood out was the strong intrinsic motivation that athletes generally have. They enjoy their sport so much that having to say "no" to many other things is not difficult. They have fun and get a lot of energy from the continuous improvement that they experience. This improvement does not come easy, though.

> "
> You can develop a lot of skills, but especially the drive, the intrinsic motivation and discipline, making hard agreements with yourself, that is something people in sports can do very well.
>
> *Pieter van den Hoogenband - Swimmer*

Intrinsic motivation is crucial because, in addition to talent, both perseverance and discipline are important in order to reach the top. If you do not have all three, it is very hard to be successful at the highest levels. Even when athletes have this combination of talent and discipline and they are successful, many still study on the side, because they will retire at some point and need a "normal" job. There are a lucky few for whom being an athlete means that they are set for life, but the reality for most athletes is that they need to have a job on the side or at least prepare for working life after they retire from their sports career. For instance, hockey clubs invest in the future of their athletes and prepare them for a civil career as well. This means that, in addition to the pressure and time investment of performing at the highest level, athletes need to invest time in their future. This is an example of how motivated they are for their sports.

Several studies found that there is a strong link between intrinsic motivation and productivity (e.g. Coens & Jenkins, 2002; Pink, 2011; Baldoni, 2013). Would it not be great if organizations could enable their employees to find their "sport" and thereby automatically increase intrinsic motivation? How can organizations let their people play (i.e. work) to their strengths?

Figure 3: Succes factors enabling high performance of top athletes

3.2. In search of continuous conversations and feedback

Athletes and teams are constantly discussing their performance and progress. This feedback is fact-based, instant and solicited. A very important element here is that athletes do not only focus on the results but are equally interested in the "how." In order to reach their goal (reach #X position in the ranking, qualify for the world championship, win a gold medal in the Olympics), smaller goals are set that can be used to track performance. KPIs are then applied to measure progress.

> " Game results do not give you the full picture. You need to have underlying data. As a coach I use a lot of game analytics. I record things like percentage of ball possession, the number of times we are in our opponents' goal area etc. It shows how we are getting better in the process, and how each of us contributes. The game result is just half the picture.
>
> *Teun de Nooijer – Field hockey player*

In addition to the results side of managing the performance of athletes, we increasingly notice that time is spent on the softer side of performance. Individuals in teams analyze their roles and drivers, and determine how to best contribute to the team. In preparation for the new season, teams determine their purpose and vision as well as the way to get there. They are supported by psychologists and mental coaches. One team even went on a military-style teambuilding training before a big tournament. The experience provided them with the tools and the mental resilience to function as a high-performing team and deal with setbacks more effectively.

> " You can set yourself a quantitative goal: for example 5 wins per year. But from a quantitative goal can't determine points for improvement. That is why you must also set process goals: how do you want to grow? Or, for example, how do we want to be leading in the analysis of the race?
>
> *Maarten Tjallingii - Cyclist*

3.3. Process more important than winning medals

Something that stood out in all interviews was that the end goal is important for top athletes, but that the process of getting there is equally important. A gold medal after a below-par performance in the tournament felt less rewarding than a silver medal that required the team to give everything that they had. Furthermore, as the continuous improvement in their skills and the team performance is what is the most rewarding, they are not looking for financial rewards. Athletes work toward clear goals, and continuously strive to improve their skills and abilities. This corresponds to Daniel Pink's theory about motivation and rewards: it is the purpose and mastery that motivates people, not the financial reward.

> " If someone did not score, but his task was to run a tackle and did a fantastic job, you can still reward him. That deserves a sticker.
>
> *Paul van Ass – Field hockey coach*

4. Current PPM:
What can be learned?

Earlier, we briefly touched upon the main changes in PPM that we have come across during our research: continuous conversations, changes in appraisals, and changes in the link between performance and reward. In our study, we found that the intentions are generally good and in line with theory. However, there is still room for improvement. Below, we describe the findings from our literature review and interviews in greater detail.

4.1. Both quality and quantity of conversations are important

Many traditional performance management cycles consist of two to three conversations annually. One conversation is to set goals, usually determined top-down. Another meeting in the middle of the year aims to discuss how the employee has performed so far compared to the target and what to improve upon. Finally, at the end of the year, an appraisal meeting takes place during which the manager informs the employee of the evaluation of their performance. This is generally done using a rating and/or ranking, where the performance is compared to other colleagues' performance. In most organizations where we conducted interviews, this process was replaced by more frequent conversations focusing on the development of the employee.

In their Global Leadership Forecast 2018, EY and DDI[3] found that more frequent conversations which centered around development increased the effectiveness of PPM by 49%. Especially the focus on development is crucial: it is better to have a 75% development-focused conversation once a year than a 25% development conversation weekly. It will enable the employee to improve the skills that they need in order to do their job well and start to take more ownership of the process. Both will increase intrinsic motivation. Another benefit of more frequent conversations is that they enable organizations as well as their employees to adapt to the rapidly changing environment and focus on the future instead of only looking back.

All in all, this sounds promising. However, we found that there is often still a lot of room for improvement in the following areas:

Quality of the conversation not high enough
A frustration that we heard in many interviews was a lack of managerial capability to facilitate development conversations and to coach their employees. Only few managers realized that they needed to upskill in this area. Many managers currently still place great emphasis on the "what" instead of the "how" and do not invest the time necessary to coach the employees. It is also questioned whether they understand why their employees are motivated to come to work each day. Some interviewed employees wondered if their managers were even interested in doing this. Different studies confirm that organizations need to invest more in the capabilities of their managers. CEB (2016) estimates that only 5% of the managers has the right skills to manage talent effectively in the absence of ratings, leading to a 14% decrease in conversation quality and lower engagement scores. The NeuroLeadership Institute (2016) found that many of the organizations surveyed in their study had increased conversation quality in year two after implementing new PPM systems. However, they also concluded that the ability to conduct quality performance conversations is a skill that must be developed over time. Continuous training and development is necessary for quality conversations and overall PPM effectiveness.

Time spent on PPM decreased
In addition to lacking managerial capability, the CEB research has shown that managers did indeed save time with the new system. However, this freed-up time was not spent on ongoing conversations with their employees. Organizations should therefore set expectations around the frequency of conversations. Most of the organizations that we interviewed did this, prescribing the PPM process in great detail. One organization actually did the opposite and gave responsibility for the conversations to the employee and the manager. They reasoned that what makes up a good conversation (including its frequency) differs per employee. One might prefer a weekly 15-minute chat at the coffee machine, while a monthly one-hour conversation works best for another. They monitored the results through engagement surveys and the initial results looked promising.

3 DDI is a management consulting firm focusing on leadership.

4.2. Do not drop appraisals without a good alternative

We came across different approaches for appraisals, from keeping them as they were to dropping them altogether. Many organizations dropped the ratings and rankings, and there is a lot of literature to support this decision.

> ❝ Appraisals and ratings: it kills people. What would work better is to train people's mental resistance based on kindness instead of fear.
>
> *Jacky Reardon – Tennis player*

The NeuroLeadership Institute (2014) argues that ratings trigger "fight or flight" reactions and that the response in the brain is similar to its response when there is an imminent physical threat like a confrontation with a wild animal. Furthermore, people tend to overestimate their performance: 98% of all people think they are above-average performers and an impressive 80% think that they are in the top quartile of performers (Coen & Jenkins, 2002).

Consequently, awarding them with an average or even below-average score will be disappointing and demotivating. When looking at the distribution of performance, a bell-shaped distribution of performance scores was assumed in many traditional PPM processes. However, we know that people's performance does not follow a normal distribution but is better represented by a Paretian distribution, represented in the figure below in black (O'Boyle Jr & Aguinis, 2012). When rating people according to a bell curve, the distribution is therefore very unlikely to represent actual performance.

Figure 4: Paretian and bell curve distribution
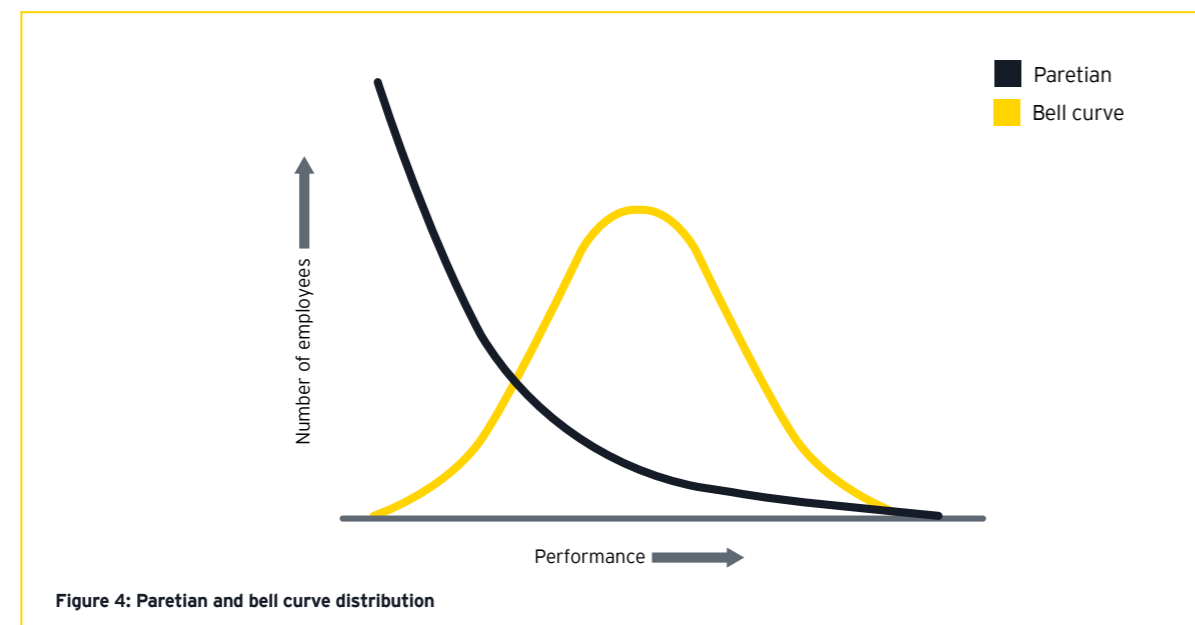
In addition, the process to determine ratings is generally subjective, arbitrary and strongly influenced by the purpose of the rating. Research found that when appraisals and ratings are used for decision-making on rewards, employees are more likely to receive a higher rating (Greguaras, Robie, Schleicher, Goff, 2003). One organization that we interviewed performed an extensive analysis of the correlation between annual ratings and the performance of the organization when designing their PPM process. They expected higher ratings in good years and vice versa, because they assumed that better individual performance had led to better organizational performance. However, they found the opposite to be true. Apparently, managers were reluctant to give low ratings, arguing that "results were not great, but they put in such a good effort." In good years, ratings were relatively low because managers corrected the ratings that they perceived as too high considering the effort that employees had made throughout the year. As a result, they wondered why people invested time and energy in a process that is not effective.

However, simply removing ratings may not be the solution either:

Where do I stand?
Without appraisals and/or ratings, and in the absence of constructive feedback and other evaluative means, it is more difficult for employees to know where they stand. CEB research (2016) found that managers have more difficulty engaging their people in the absence of ratings. They needed to find new ways of recognizing high performance. This lack of clarity, especially when combined with reward decisions, can actually be demotivating due to the increased perception of unfair pay differences. When deciding to drop ratings and appraisals, it is hence crucial to invest in managers' capability to effectively assess employee performance. A study by the NeuroLeadership Institute analyzing the state of new PPM systems in year two after implementation found that this is exactly what successful organizations did.

> ❝ The unwritten rules are more important than the what is explicitly said. Everyone is driving each other crazy and decides for themselves what the standard is.
>
> *HR Manager*

Ratings still exist
Even if organizations get rid of formal ratings, informal ratings still exist. They are done subjectively, behind the scenes and without input from the employee being evaluated. This was a frequently discussed issue in our interviews at one organization in particular: the black box around evaluations and the link to decisions around rewards in the absence of ratings. In this specific case, the culture was still centered around top-down ratings and labels. It was not clear to the employees how they would be evaluated at the end of the year, which caused a lot of frustration and slower adoption of the new PPM system.

4.3. Reward decisions should be fair

Without an apparent link between performance and reward (appraisals in the sense of ratings and rankings), organizations developed new means to make reward decisions. The organizations that we interviewed used different approaches in this context.

Quantitative and qualitative measures determine reward: Different factors to determine pay increases are assessed, including targets like utilization and sales but also qualitative elements such as the impact that an employee had on the client, the team and the wider organization.

Employee behavior drives reward decisions: Another organization still looks at KPIs when determining pay decisions, but the impact of the employee's behavior is a lot bigger. In other words, the focus is here on qualitative measures.

Qualitative ratings focused on development drive reward decisions: There are organizations that do not use ratings (e.g. a 1-5 or similar scale) anymore but evaluate someone using a label (e.g. development needed, average performer, outperformer). They then link that with a merit-based salary increase. In practice, though, we found that these labels are used in a similar way as ratings and that the employees which we interviewed also perceive these labels as a rating.

Reward decisions are individual: Finally, one organization now gives managers complete freedom to determine how they think that they can best divide the "bag of money" at the end of the year. This demands a different managerial skillset than the traditional appraisal and reward process, so they train their managers in what to take into account when making these decisions. Questions include: What is the impact of giving nominal or relative raises? Do I want to reward performance or tenure? Do I want to differentiate between employees who are at the beginning and end of their salary scale? In addition, the organization uses these trainings to create consistency in decision-making throughout the organization.

From a theoretical perspective, there is evidence to support the removal of the direct link between performance and reward. The assumption that money is needed to motivate people does not hold for most jobs nowadays (Coen and Jenkings, 2002), as the jobs are complex and demand more creative problem-solving skills than jobs at the beginning of the 20th century did. Frederick Herzberg concluded that money is not a motivator and is even a powerful demotivator. If pay is not adequate or appears unfair, it will demotivate most of us. However, this does not mean that money motivates individuals; it is simply to be viewed as a "hygiene factor." According to Daniel Pink, intrinsic motivation results from purpose, autonomy and mastery. Second, pay-for-performance schemes can bring unintended, unhealthy side effects such as short-term thinking, which severely undermine performance and organizational objectives. Furthermore, as for productivity, many studies have conclusively shown that people who expect to receive a reward for completing a task or for doing that task successfully simply do not perform as well as those who expect no reward at all (Alfie Kohn, 1993).

Why does frustration still exist around removing the link between performance and reward?

> "If I feel that I become a slave of KPIs, I will immediately quit my job.
>
> *Employee*

Use of KPIs for appraisals can be demotivating
Many interviewees indicated that they severely disliked the use of KPIs for their appraisals and some even said that it was demotivating, especially when the focus in the conversations that they had with their managers was on the "what" instead of on the "how." Young & Kaiser (2013) even stated that the use of KPIs for making pay decisions can be dangerous. However, this does not mean that KPIs cannot be useful for organizations. When they are used in order to measure progress much like athletes do, and to learn and improve, KPIs can be very beneficial. Any complex organization must be indicator-intensive, otherwise there is no practical way to gauge how well processes are running and/or to know how these processes can be improved.

> "Coach kids on their task and effort, because that they can influence. Once they experience that they can get great results with hard work, their intrinsic motivation will increase. This makes them less dependent on compliments.
>
> *Joyce Sombroek – Field hockey player*

Managers do not always have the right skills to make fair reward decisions
Similar to the discussion above around appraisals, the responsibilities on manager's shoulders to make fair reward decisions have greatly increased. They need to have the right knowledge and capabilities around reward decisions, which was unfortunately not always the case for the organizations that we interviewed. Especially when it was not clear how reward decisions were made, frustration and demotivation issues arose: perceived fairness strongly decreased, as is supported by McKinsey research (Chowdhury, Hioe, Schaninger, 2018).

> "Showing vulnerability is not part of this organization's DNA. However, with giving and receiving feedback, this vulnerability is very important.
>
> *Manager*

Cultural elements need to match new PPM system
The organizational culture of several organizations that we interviewed had not changed at the same speed as the new PPM system. People still valued the link between performance and reward, so when this link became a lot less clear, this led to frustration. By contrast, there was an organization that analyzed the organization culture and used this information when redesigning their approach. Furthermore, they adapted the change management approach for implementation to what they found out about their organizational culture. This helped increase the adoption of the new system, something that other organizations struggled with.

5. Balancing organizational and individual needs: Performance Activation

As discussed earlier, there is an inherent paradox in control and development purposes. Organizations need both, but by focusing on one over the other, they fail to realize them at the same time. Therefore, we think it is important to not look at the PPM challenge in an "either/or" manner. Rather, organizations should look at it from a "Performance Activation" perspective, where they aim to balance the tension between the organizational and individual objectives. Several elements make up the Performance Activation framework and all of these elements need to be addressed when looking at increasing its effectiveness. This means that you do not have to choose between employee motivation and the organization's view on their performance.
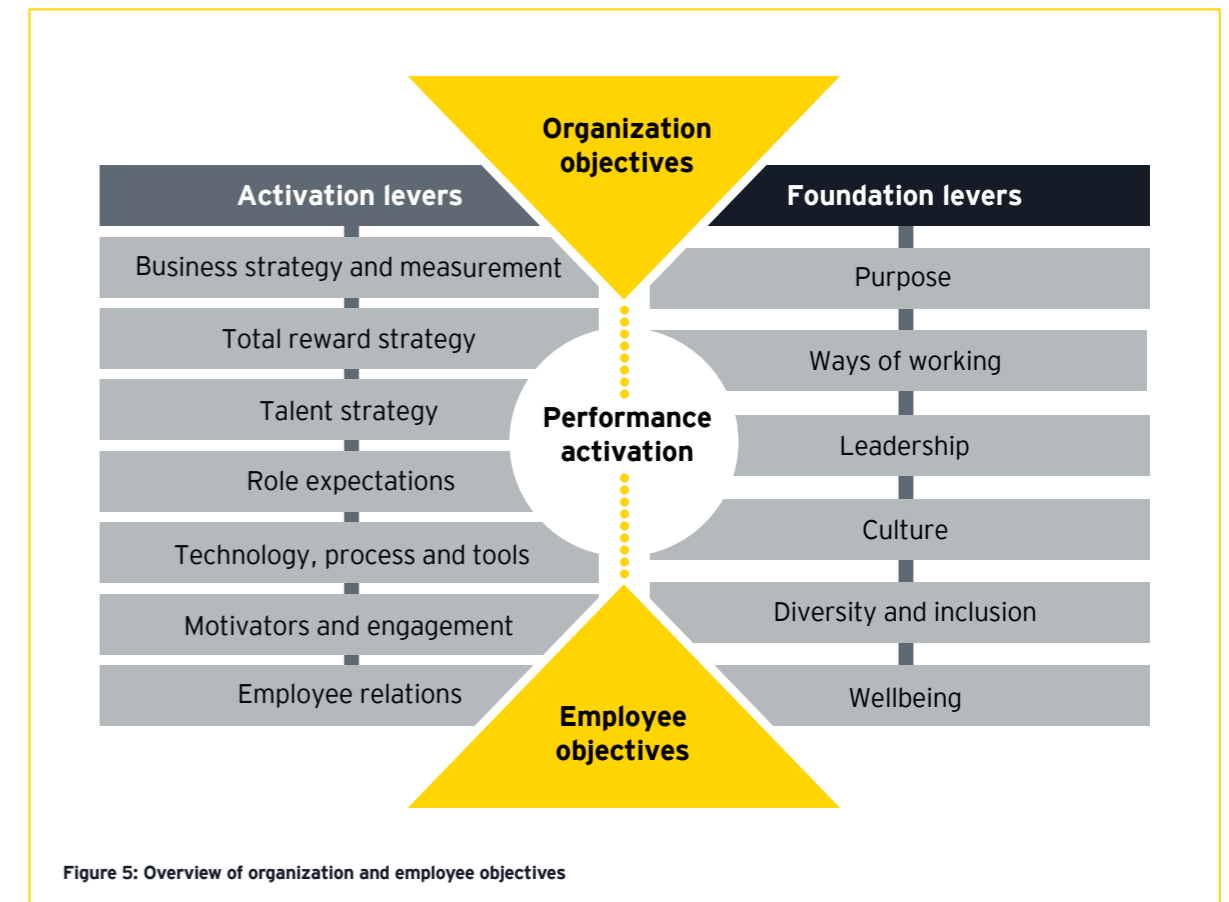
It is important to note that we call it "Performance Activation" instead of "Performance Management." The rationale behind this is that to "manage" implies that it is an action which "happens" to an employee rather than a process that employees engage in. If an organization truly wants motivated, engaged and empowered employees, Performance Activation (PA) requires mechanisms to be put in place that will allow employees to take the lead and accept responsibility for their performance. An organization is then seen as an enabler of performance.

5.1. Levers to create balance

In the PA model, we differentiate between activation and foundation levers:
▶ Activation levers: Factors that directly affect the PA design and process
▶ Foundation levers: Organizational practices that can be optimized to facilitate high performance

Activation levers	Foundation levers
Organization objectives	
Business strategy and measurement	Purpose
Total reward strategy	Ways of working
Talent strategy	Leadership
Role expectations	Culture
Technology, process and tools	Diversity and inclusion
Motivators and engagement	Wellbeing
Employee relations	
Employee objectives	

Performance activation

Figure 5: Overview of organization and employee objectives

5.1.1. Activation levers

We have identified seven activation levers for factors that directly affect the performance activation design and process.

1. **Business strategy and performance expectations:** Communication of the outstanding performance expected by stakeholders and the way that the organization will achieve its long-term objectives

2. **Total reward strategy:** The design of fixed and variable pay, benefits and non-financial rewards to engage and recognise employees, incentivise long-term performance, and attract and retain talent

3. **Talent strategy:** The approach to effective talent acquisition, learning and development, leadership development, succession and careers

4. **Role expectations:** Clear expectations of what constitutes role success, encompassing both outcomes (the "what") and contributions and behaviours (the "how")

5. **Performance process:** The way in which performance is reviewed and enhanced, including just-in-time feedback and coaching to improve performance

6. **Motivators and engagement:** Other intrinsic factors that motivate individual contributors and engage them with the organization

7. **Employee relations:** A fair and consistent approach to managing employees, which encompasses communication, process, documentation and planning for performance improvement while enabling agility for the organization

5.1.2. Foundation levers

In addition to the aforementioned elements that directly influence the design and process, the following important organizational practices can greatly enhance the effectiveness of PA.

1. **Purpose:** Having an aspirational reason for being galvanises stakeholders around a single belief and provides a sense of identity

2. **Ways of working:** Identifying and aligning decision-making, information use and processes helps bring the purpose to life

3. **Leadership:** Building the capability of leaders to inspire, motivate and support high performance means that leaders are no longer a passenger but rather the igniter of the process

4. **Culture:** Designing, building and driving a company culture enables a match between employee and organization values, desired behaviours and aligned structures

5. **Diversity and inclusion:** Respect for and encouragement of diverse perspectives and experiences drives innovation

6. **Well-being:** Establishing the relationship between well-being and performance – understanding the factors that interact with people's ability to work at their best – allows you to unlock workplace productivity

5.1.3. Performance Activation like a suspension bridge

Similar to the suspension bridge in the image below, there should be tension between all the different levers of PA in order to create an effective system as well as sustainable individual and organizational performance. The tension of the countervailing powers of the bridge creates it's strength. If the road represents the road to improved performance, the two pillars on the left side on the bridge represent the organization objectives. They are supported by business strategy and performance expectations and founded in culture, leadership, employee relations and diversity & inclusion. The two pillars on the right represent individual objectives, supported by motivation and engagement and founded in purpose, wellbeing and ways of working. The four pillars are connected through role expectations, performance process, talent strategy and reward strategy.

The continuous shift between the control and development focus of PPM described in chapter 2 can be explained by the bridge: too much focus on the organizational objectives will lead to a collapse of the bridge, but so will an excessive focus on individual objectives. Every time that the PPM bridge collapsed, organizations therefore put strong emphasis on the other side of the bridge, which again led to a collapse. A well-balanced bridge results from alignment between all the different levers that hold it together and will lead to increased strength.

We believe that PA does not come in one shape or size. For each organization, these factors will have a unique impact on the activation of performance, depending on the industry, organizational culture and context. This starts with understanding the foundation and environment of the organization, as well as the specific levers that can be used to create the optimal performance strategy.

6. Conclusion and recommendations

In this report, we provided a historical overview of PPM over the past century. From time to time, the focus shifted from control to development and back. Currently, many organizations are focusing on the development side of PPM. Even though organizations tried to combine the two purposes in one system, the focus was usually on one over the other, driven by external factors. This choice has generally been viewed as an "either/or" scenario, in practice and in literature. So far, however, this has not led to desirable results.

This seems to be caused by the paradox of control and development: an organization needs both but is unable to achieve them at the same time. For example, letting go of the concept of ratings and rankings to improve employee motivation only works when elements like culture and manager capability are taken into account. Similarly, an organization can opt to remove the link between performance and financial reward but should ensure that the decisions are still perceived as being fair.

From the world of sports, we learned that there is a natural balance between control and development. Athletes have clear end goals in mind but focus on the process to get there, using KPIs as a means to measure progress. Their performance in all its details is continuously discussed with their coach and/or team to improve their skills. This continuous growth and the fun resulting from it drives their strong intrinsic motivation.

Therefore, we argue that organizations should similarly consider all elements of their PPM system and align them in a true balancing act. The concept of Performance Activation (PA), as illustrated by the suspension bridge, can be used to find this balance. PA is based on the belief that both organizational (control) and individual (development) needs should be met in order to effectively manage the performance of employees and the organization. Organizations need to consider all elements of the Performance Activation framework as the balancing act in a suspension bridge and ensure that they all work together seamlessly.

We encourage organizations to reflect on their PPM system, and to consider both the organizational and individual needs from the Performance Activation framework, instead of going back and forth between "control" and "development." An interesting first step could be to look into the current PPM system and its effectiveness in order to identify the issues that determine the current state as well as possible inconsistencies and challenges. The following questions can guide organizations in this process.

Evaluate current state:
1. What does the PPM system look like?
2. Why is it organized that way? What does the organization want to achieve with PPM?
3. What makes it effective? Which bottlenecks in any of the levers hinder the organization in achieving its intention?
4. To what extent are all the foundation and activation levers in the PPM system aligned?
5. Which of the issues identified in the PPM system need consideration in order to increase alignment between the levers and move toward Performance Activation?

We found that there is no one-size-fits-all solution to the people performance question. Therefore, we do not present an either/or solution that works for all organizations. We believe that looking at the questions above from the perspective of the organization and adapting the people performance approach accordingly will greatly increase its effectiveness.

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