Performance Ratings and Forced Ranking – One Foot in the Grave?

part of our We Think… series

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One Foot in the Grave?

There seems to have been something of a shift in Performance Management (PM) practices recently; a number of large organisations such as Deloitte, Accenture, Gap and Adobe have been in the industry press for transforming their PM processes. You might be forgiven for thinking that these organisations have scrapped performance management altogether, but PM remains the main vehicle by which an organisation maintains oversight, ensuring that its employees are working on the right things, that overall levels of performance are improving and providing information on how well people have done.

A survey conducted by Mercer in 2013 showed that 95% of organisations set individual objectives and 89% have some kind of end-of-year performance rating. Those figures are likely to be reducing, but the reality is that most companies have – and will need to continue to have – some form of performance review process. So the current publicised trend is a movement away from traditional, rating form-based and ranking systems to a more fluid, conversation-based, flexible and individual approach to managing performance.

This is nothing new to many of us, and it reflects an approach that we, at Head Light, have championed for many years and the features and functionality within our software enable our customers to take a personalised, flexible and continuous approach to managing performance. It's about driving performance conversations and not driving performance ratings.

However, many organisations have found it difficult to take a less structured, less form-driven approach to PM for a range of reasons; some of them very sound ones, others less so. Often, legacy, HR's perception of line managers and inertia can prevent an organisation from making sweeping changes to core talent management practices, but we should be heartened by the stories from organisations such as Microsoft, which had long evangelised about the benefits of its approach to PM, where employee performance is judged relative to your peers.

The management research firm CEB reports that in the US, 6% of Fortune 500 companies have disbanded their ranking system. Accenture has stopped stop using its annual evaluation and ranking process because the paperwork was time-consuming and the process was a source of general frustration for everyone. Its new system will see employees receiving more timely, ongoing feedback from their line managers following a project or assignment. Deloitte is piloting a similar approach, where performance evaluation is done on an incremental basis throughout the year, rating scales have become four simple questions with 'yes/no' answers and the forced ranking approach has been removed.

Whose forced ranking is it anyway?

For any organisation still using such an approach – and feeling the pain from it – it is probably useful to consider the reasons for having such a process in the first place.

Early adopters of this system include Ford and GE; Jack Welch is sometimes credited with having pioneered it – his 'vitality curve' or the '20-70-10' system sought to identify the top 20% of the workforce which was the most productive and therefore should be nurtured, retained and rewarded, the 'vital' 70% who are adequate and should also be kept, and the final 10% who should be fired. Fans of this approach credit it with a 28-fold increase in earnings and a 5-fold increase in revenue at GE between 1981 and 2001.

There are some pretty good organisational explanations as to why so many of us have had to move people up or down an appraisal rating point in order to 'fit the curve' – and then explain it to a perplexed employee afterwards. Statistically, having performance plotted on to a normal distribution curve makes common sense; within any population, a small proportion of people will be performing at a lower than average level, a similarly small proportion will be performing at a higher than average level, and the majority of the people will be in the middle somewhere.

The problem lies in how the level of performance is measured, judged or assessed. Forced rankings, - whilst most people find them limiting, impractical and even damaging have their roots in a number of positive intentions, including:

- Helping to make managers' assessments fairer and more accurate and not subject to individual biases (such as leniency, severity, central tendency and self-interest), through moderation sessions where decision-making is checked and challenged.
- Asking people to consider where an individual is performing compared to a group enables us to segment the employee population and apply differential rules for managing those people according to which segment they are in (e.g., Where should we focus our performance improvement efforts? Who might we look at for promotion?).
- It lends itself well to one way in which pay and performance can be linked; to identify who deserves a pay rise, who should be entitled to a bonus, and how much should that bonus be? It is a model that helps us to manage, and to make seemingly fairer reward management decisions.
- Forced ranking should raise awareness of the importance of performance and productivity. It should increase the amount of energy people put in to managing performance and pay more attention to the criteria they use when making assessments of others' level of performance or contribution.
- Individuals should know where they stand, and how they compare to others. It's a question we all ask ourselves naturally (anyone who has school-age children will understand the temptation to ask "*But how are they doing compared to the rest of the class/year?*") and forced ranking should make this more transparent.

But of course we can't talk about forced rankings without discussing the down-side. Its critics say that forced ranking and the associated moderation process inhibits teamwork, stifles creativity and can be very demotivating for genuinely high performing employees when they're forced into the average category. Forced ranking gives the *illusion* of being able to fairly benchmark people across the organisation but it actually only really allows for comparisons *within* a team. Since the rating of performance is still largely down to the team leader, when you plot a whole organisation on a curve you do away with measures of absolute performance and effectively using a variety of criteria and differing uses of the scale. Therefore, you could have two identical bell curves for two different teams (relative performance of individuals) but the performance outputs from each team could be wildly different. Making decisions as to whom should be rewarded on this basis is likely to be unfair.

Among the reasons given by the big companies mentioned earlier for moving away from forced ranking, is that internal research suggests that the time, money and effort spent on this aspect of management didn't actually achieve what it was intended to: to ultimately improve performance. And external research suggests that other practices, such as regular feedback and providing better career or personal development, have a far more positive impact on both engagement levels and performance metrics so managers' time and energy are best focused in these areas.

In ditching forced ranking, what do we need to consider?

Clearly, moving away from forced ranking will have different challenges where there is a direct link to pay. For those organisations who do have a connect between forced ranking and reward, of course it is going to have an impact on the way that reward budgets are managed, especially where a top rank marking is linked to pay increase or bonus levels and careful attention needs to be given to the quality of managerial assessments. Organisations in this position need to watch for potential abuses of the system.

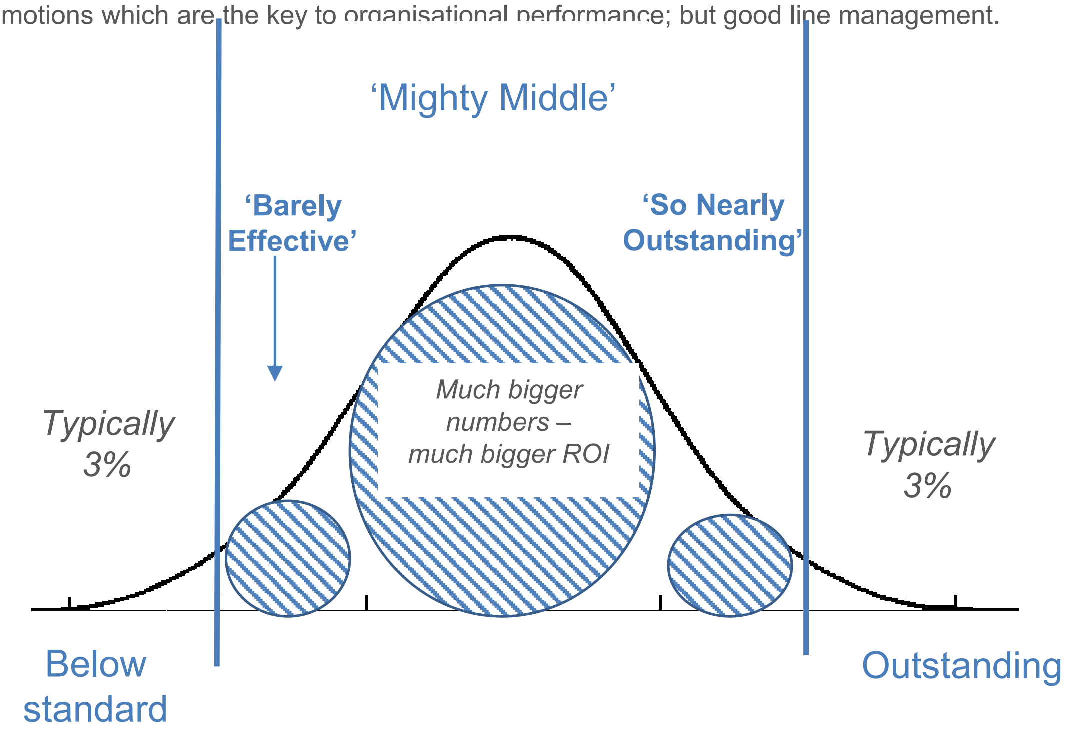
Not all organisations have this link and the question for them is perhaps simpler – forced ranking or no forced ranking? Even if there is no hard link to pay, there will still be challenges, as there are with any change, and you may be required to create a business case which specifies how the organisation will manage the risks associated with it. Here are a few points that you could consider including when trying to persuade key stakeholders to abandon this practice.

Firstly, you might look to case studies such as Microsoft and Deloitte and search for data within your own organisation that would provide similar arguments. Key levers for organisations in moving away from the approach are:

- **Feedback from employees** – through annual or engagement surveys or from quantitative analysis of employee appraisal final comments, or focus groups.
- The **drive to increase teamwork, collaboration, innovation and engagement** – companies report forced ranking as stifling these behaviours.
- The **time it takes** to engage in the reviews which moderate rankings, to have subsequent discussions with individuals, and to manage the impact of this on the team, is costing managers valuable time which could be better spent coaching, developing, motivating and giving feedback.
- Many companies report **little or no positive link between their PM efforts and increased share value,** or organisational performance more generally.
- The once-a-year forced ranking assessment and practice **oversimplifies the picture of 'performance',** which should be evaluated on more flexible and ongoing basis, given the frequency of change and shifts in priorities.
- Forced ranking tends to lead to a situation where you **under-reward the top achievers,** c**ompletely demotivate the lower achievers and do very little with those in the middle.**
- Generally, performance management processes are usually **massively complex and place a significant demand on an organisation's resources** (both line managers and employees). This is usually most keenly felt at the end of the financial year end when people are focusing on reporting, sales performance and business planning. Allowing people to focus on these key business processes, rather than distracting them with appraisals, is likely to be a popular move.
- Decoupling the reward system from the performance management system is also a feature – taking away the risk of having too many top rank employees needing a pay rise means that organisations can have more honest conversations about where someone is and what they can do to be even better. Rather than directly linking ratings and salary increases or bonuses, compensation decisions should be based on the critical nature of an employee's skills, the cost of replacing them, their value to customers, and the external labour market.

The reality in most organisations is that Welch's 20-70-10 approach works perhaps in a way that wasn't intended. The model tends to forces you to focus on the exceptions, rather than the majority. It is usually clear what happens to the top 10% of performers (they get the largest bonuses, the biggest pay rises or the best opportunities for development and advancement) but the middle 70% get largely overlooked or ignored. And managers and HR tend to spend too much time implementing performance improvement measures for the bottom 10%, putting them on internal 'priority movers' lists or sending them on training courses, with very few actually being managed out of the organisation. And what about the people who are just inside the lower end of the 'average' band – effectively they are getting a 'no change needed' message through their performance reviews. Is this right?

In fact, you could equally re-express the way in which the bell curve is often use in practise in the diagram shown below. In reality, most organisations using a normal distribution approach tend (no matter how many different 'ratings' are employed) to behave in similar ways at either end of the spectrum i.e. those seen to have performance below and acceptable level, and those seen to have performance at an exceptional level. When ranking employees, organisations typically rank just between 3% and 4% of employees at either extreme. This tends to put a disproportionately large organisational focus on a very small percentage of the employee population. At the same time, it takes focus away from important populations just the other side of 'the line'. The implication of such approaches is that, at the poorer performing end of the spectrum, 7 out of 10 of the oft-referred to 'bottom 10%' are actually rated 'effective. At the other end of the spectrum, a significant number of people who are so very close to being exceptional, get the same message. Statistically, these two 'hidden populations' could make up more than 30% of the employee population. Surely simple maths should dictate that the organisation should get a greater return from driving incremental improvement year on year across larger numbers of people, than in focusing on just 6-8% of its people – many of whom are statistically more likely to leave the organisation in any case. This is the concept of the 'mighty middle' as it is sometimes called, where it is neither Performance Improvement Plans nor promotions which are the key to organisational performance; but good line management.



Performance Management: The Next Generation

In a very popular document published on the web, Netflix has described its approach to HR management, including hiring talent, letting people go and performance evaluation. In short, they don't do the latter. Netflix abandoned formal reviews some time ago, seeing them as being "too ritualistic and too infrequent". Managers were encouraged to have frequent and honest conversations and made better use of the data available through improved business analytics to provide a more accurate picture of how people were doing.

Performance Improvement Plans (PIP) were also scrapped because they were seen to be misleading: most people who were put on a PIP were those whose skills and abilities no longer fitted with the emerging role requirements, largely driven by new technology and changes in the market. The intention was not really to improve their performance, it was to create a paper trail to show that performance was not improving with the view to managing them out of the organisation. Coupling some really decent payoffs with an open and honest conversation about fit and the changing nature of the role seems to have served Netflix well. What's not clear from the publicised information is how Netflix deals with people whose skills and abilities are up to date and meet requirements, but who underperform for other reasons. In the absence of a PIP, they would need to equip their managers with very robust skills around having critical conversations, feedback and managing underperformance. It would be unwise to reward lack of effort, low motivation or a high error rate with a big fat severance cheque…

Netflix effectively replaced their formal performance review process with an informal 360 degree feedback process. They deliberately kept to a simple 'stop, start, continue' set of qualitative questions and over time moved away from doing this in an anonymous fashion, towards having people sign – and own – the feedback they gave to others and many teams have opted to give feedback face to face. How refreshingly adult and open.

Of course, many organisations are not ready to take a step as large as this, but there are things that can be done to move performance reviews on to a more mature, open and forward-looking footing.

Firstly, those ongoing conversations about performance between manager and direct report are crucial. If you're not doing this already, then you need to be training managers in providing high-quality feedback, having critical conversations, challenging underperformance and motivating and engaging teams and individuals. The conversations should be the focus of the PM process, rather than the form, or the end-of-year ratings. The quality of these conversations needs to be audited in some way, so perhaps there are questions in your engagement survey which can be used to track line manager effectiveness here.

Secondly, bring your 360 into the fold. Most organisations use some kind of multi-rater feedback process and this can provide invaluable performance information, which transcends the manager-subordinate relationship and the potentially limited view and biases that brings. We have long said that, if you want to know how well a manager is leading his or her team, why only rely on the view of the line manager? Surely the team – the people he or she actually manages - will have a more insightful, accurate and valid view.

This might mean taking a critical look at your 360, asking yourself the following questions:

- Will our 360 software/process allow us to take a journey towards a culture of greater openness and honesty with regards to feedback? Can people provide anonymous feedback for now and is the system flexible enough for us to allow people to 'sign' their feedback if they choose?
- How flexible and tailorable is our system/process? Can we tailor it to different roles, parts of the business, individual teams? Can people add and ask their own questions, if there are particular behaviours or areas of performance on which they would like feedback?
- What do the reports look like? Do they support good quality conversations between managers and direct reports? Do they provide guidance on development, strengths, areas where there has been significant improvement and coaching-type questions?

- Can we export the data from 360 degree feedback and use it to inform other aspects of talent management and L&D (e.g., succession planning, promotion, training needs)?
- Can individuals use their feedback to easily create personal development goals, to track progress, to collect ongoing feedback from trusted colleagues, managers, coaches or mentors?
- Does the system/process produce data that can help to show that there are improvements in performance over time?

Thirdly, place more trust in your managers. Taking the artificial construct of the bell curve away, many organisations have given more latitude to managers for rewarding performance and have found that they are capable of making fair and consistent judgements and make good decisions regarding recognition. Some organisations provide their managers with a reward budget, which would consist of a nominal bonus amount for each team member and the manager has to decide whether to effectively take away from the majority in order to recognise the strong contribution of one or two individuals. This will certainly make them think very carefully about how to distribute the pot, on what basis they are making the allocation and how they are measuring performance. They are also then responsible for ensuring that people within their team do what needs to be done to meet organisational requirements whilst balancing this with individual interests and strengths.

Peak PM Practice

There is a simple equation at the root of all this, which is perhaps worth bringing out. Evidence shows that successful performance management is about balancing three things – process, skill and behaviour. If you are light on manager skill and behaviour, then the process has to compensate and you end up with complexity, lack of ownership and all the current issues. Develop skills and behaviours and the process element can take a back seat. What we are living with now is simply a couple of decades' worth of not investing in the skills and behaviours of managers, so is it any surprise that we end up with process-heavy performance management approaches? This has been a self-fulfilling prophecy, since if we're being really honest with ourselves, a common reason for driving process into performance management is the belief that this will mean that performance is at least discussed once a year! Of course, in doing this, we reinforce performance management as an HR process, not a management responsibility, and pour effort into process improvement rather than skills enhancement.

What the current trends and changes in the PM playing field mean – in short – is that our managers need to be really good at giving open, honest and constructive feedback and at having challenging conversations with people. And organisations need to place much greater trust in managers to manage people well and make sound decisions regarding their team. Typically, many organisations do not extend this level of trust to their line managers and that's partly why we have practices like forced rankings in the first place.

We've talked about skills training and the art of conversation, but another thing that organisations can do to improve the quality of performance management practices and of decisions made by line managers is to train them in managing personal biases. We need to accept that biases are natural – we all have them – and in many cases they help us to deal with the complexity of the world around us and the wealth of data that floods us every minute of the working day. But we can help our managers to be more aware of their personal biases, how these operate and the impact they have on their decision-making. We can provide them with tools, techniques and strategies to help them manage their biases. Facebook recently publicly shared their online programme (https://managingbias.fb.com) and a series of videos which educates people on the main biases associated with management and assessment, which they've introduced as a part of their strategic drive to become as diverse as an organisation as their user population. A stretching goal, perhaps, but one which is so important to them that they've invested heavily in raising awareness of biases.

There are organisations that specialise in diversity training but if you're going down that route ensure that the training incorporates building awareness of biases and strategies for managing them and ensure that you weave those messages through other training where biases might have the biggest impact. Systematically putting people through diversity awareness training or a similar programme will have an impact to a degree, but really helping managers to understand how biases can operate specifically within the performance management process (and we know it does as there has been some interesting research on this recently) and how they can avoid allowing biases to treat people unfairly and making that practical link is likely to have more impact. There are other areas where awareness needs to be raised, such as interviews, succession planning and identifying high potential, so those practical links need to be made too.

Organisations should also be constantly looking at how technology can better support, drive, enable and record those performance conversations and feedback discussions. Paper-based systems may still be attractive to some because of the illusion of simplicity, but if we are to create genuinely sustainable practices, be responsive to rapid change, minimise administration time, generate usable data and save the planet all at the same time, mobile technology and social media has to be the way to go. Provide managers with a sound skills base, give them the tools they need in order to do the job of management well, and trust them get on with it.

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Next steps

If you would like to know more about how we see Performance Management practices changing, please get in touch.

About Head Light

Head Light is an award-winning talent management software and consulting firm that works with clients to define and implement impactful talent management strategies.

Talent Cloud® is our cloud-based portfolio of integrated talent management software tools designed for those who expect the maximum return from talent management processes. Our training and consulting services uniquely complement our breakthrough software that engages employees, managers and senior leaders in the selection, development and progression of people in their businesses.

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