BEYOND PERFORMANCE MANAGEMENT

four Principles OF PERFORMANCE LEADERSHIP

By Richard Greenberg and Luellen Lucid, Watson Wyatt Worldwide

During a recent conference featuring a roundtable of CEOs, an audience member asked, "What do you expect from HR?" The replies highlight three major challenges:

- Align our people with our business priorities.
- Get more value from our human capital expenditures.
- Ensure that our human resource initiatives achieve the targeted business value.

These CEOs, along with many senior executives today, expect the HR function to be a strategic partner in running the business. The good news is, most senior executives are aware of the positive bottom-line impact HR can have by boosting efficiency and profits.

QUICK LOOK

- Though most senior executives are aware of the positive bottom-line impact HR can have, HR professionals can do even more to show a connection between their work and the key result measures of business.
- Historically, performance management has focused on goal setting, feedback, documentation and attempts to administer merit pay. However, there are problems with this traditional view of performance management.
- The potential for higher returns from performance leadership systems stems from a focus on financial performance and employee development.

HR professionals, however, can do even more to show a connection between their work and the key result measures of the business.

Senior compensation and benefits managers can increase value in their companies by focusing performance management systems on driving better business results in addition to enhancing skills.

"Performance management has a dual and complementary purpose by helping us achieve our business plan and encouraging the growth and development of our employees," said Karen Williams, vice president of compensation at PacifiCare. "Focusing on business results and skill development are both critical components of the design and implementation of our performance management process."

The technology and tools available to measure and reward performance, enhance development and support succession planning activities have the power to finally transform performance management into *performance leadership*. (See Figure 1 on page 44.)

The Traditional Approach

Historically, performance management focused on goal setting, feedback, documentation and well-meaning attempts to administer merit pay. Figure 2 on page 44 shows the anecdotal shortcomings we have heard from managers and employees about these traditional performance management systems.

Many of these anecdotal findings were confirmed in Watson Wyatt's *2002 WorkUSA* survey, which included responses from 12,575 participants. According to respondents, only 25 percent of employees say their companies manage employee performance well, and 40 percent say they see no clear link between their jobs and pay. In the *2003/2004 WorkUSA* Watson Wyatt pulse survey of 1,190 workers, only 30 percent agree or strongly agree that their performance management system has helped improve performance. In addition, only 10 percent agree or strongly agree that their performance management system helps poor performers improve.

For many organizations, the merit pay process has been frozen in time even though industries and markets continue to evolve. The shortcomings of many traditional merit pay systems are well documented:

- The standard bell curve forces 50 percent of performers to be rated below average, and almost 70 percent of a company's employees must receive average or below-average increases.
- The historical paradigm of the standard bell curve distribution of performance has conditioned managers to believe that there is a wide distribution of natural ability among employees.
- The difference in merit pay between the outstanding and poor performer is so small, there is no incentive value at all.

Performance Leadership: Why It's Important

There is no question that it pays to manage people and performance right. This is substantiated by the *Human Capital Index* (HCI), an ongoing study that Watson Wyatt undertakes to quantify exactly which HR practices and policies have the greatest correlation to shareholder value.

The 2002 survey of more than 500 North American companies found that superior human capital practices are a leading indicator of future financial performance. In short, financial performance can be significantly enhanced by a company's approach to its employees. The effective use of performance management practices can be used to favorably impact the bottom line. (See Figures 3 and 4 on pages 44 and 45.)

Performance Leadership: How It's Being Accomplished

The potential for higher returns from performance leadership systems stems from a focus on financial performance and employee development. Performance leadership is built on four key principles: goal alignment, accountability, trust and values, and total rewards. (See Figure 5 on page 45.)

Alignment

Alignment connects the organizational strategy to and with its people, allowing managers and employees to take effective action. If traditional performance management concentrates mainly on SMART goals (i.e., specific, measurable, attainable, realistic and time-bound), then performance leadership drives managers and employees to focus on the "right" goals and behaviors — the ones that increase value to the business. To achieve this focus, employees need a clear line of sight as to how their actions help or hinder the company's results. If they understand the broad and specific goals, they can clearly see how their actions move the business closer to achieving its performance goals.

"An important consequence of the goal flow-down process, and improving our line of sight, is that information is no longer power because information becomes a commodity in the company," said Gloria Rodriguez, director of human resources at Interpore Cross International. "Also, as the performance of managers becomes more visible it is easier to link pay to performance."

The importance of clearly articulating goals and expectations to all levels in an organization is highlighted in the *2003/2004 Watson Wyatt Communication ROI Study*. In examining the relationship between an organization's communication effectiveness and its shareholder returns, the study shows that effectively creating

FIGURE 1: TRADITIONAL APPROACH VS. PERFORMANCE LEADERSHIP

Traditional Approach	Performance Leadership
Ongoing business dialogue	Single annual event
Stand-alone program/administrative process	Integral part of business planning
Manager-led	Shared responsibility and involvement
Anniversary date	Focal point review aligned with business cycle
Minimal differentiation in pay	Pay for performance
Manual, time-consuming process	User-friendly tools/automation to drive business results

FIGURE 2: TRADITIONAL PERFORMANCE MANAGEMENT

Employee's View	Manager's View
I haven't had a review in five years.	Everyone gets the same raise, so why bother?
My manager only talks to me when it's bad news.	It takes too long to complete a review.
What's on my form has nothing to do with my job.	Nothing happens with the data, anyway.
I'm rated "outstanding," but my increase is 2 percent.	Everyone's rated outstanding, and we're 20 percent below target.
My boss doesn't have a clue what I do.	Forms are never submitted on time!

a line of sight for employees can drive increases in shareholder value. (See Figure 6 on page 45.)

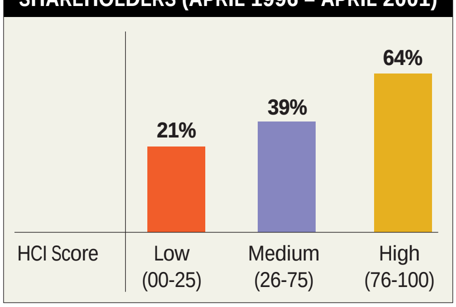
Companies achieve this impact by consistently communicating goals and expectations not only at the corporate strategy level, but by drilling down to the business unit, work group and individual levels. The communication study also found that organizations that communicate effectively outperform other organizations financially. A significant improvement in communication effectiveness is associated with a 29.5-percent increase in market value.

Accountability

This second principle of performance leadership is based on being clear about the expectations one has for others, as well as for oneself. Accountability also is based on managers and employees being held accountable for seeking out, providing and receiving honest feedback. Managers will be motivated to conduct valid performance reviews in an environment that provides the skills and tools to collect valid performance data and holds them accountable for making valid performance decisions.

Accountability across an organization is achieved through ongoing communication. Senior management, supervisors and employees set expectations that are consistent and understood. Each member of the workforce is accountable for his or her own actions, as well as for giving feedback that directs actions toward the right business outcomes. Performance leadership technology opens the channels for this communication so it becomes a core competency.

FIGURE 3: FIVE-YEAR TOTAL RETURNS TO SHAREHOLDERS (APRIL 1996 – APRIL 2001)



Sources: Watson Wyatt's *WorkUSA 2002* and *Human Capital Index 2001/2002.*

Trust and Values

The third principle for building successful performance leadership systems comes from leaders' and managers' everyday actions. A solid foundation for high-functioning organizations requires shared values, typically including respect and tolerance for diversity. The strengthening of this foundation is one of the greatest challenges for corporate leaders.

A global public opinion survey released by the World Economic Forum shows that 48 percent of people express "little or no trust" in global companies, with 52 percent expressing similar skepticism about large national businesses. This could have a negative impact on both productivity and profit margins.

Performance leadership facilitates building trust throughout the organization. Without trusting relationships, managers are unlikely to get the needed levels of long-term commitment from employees, regardless of how effective the tools and processes might be.

Total Rewards

Total rewards refers to the importance of finding the right mix of monetary and nonmonetary rewards that employees value and that can be funded and supported by a company. The single most effective way to link performance to rewards is through annual incentives. Incentives are the most highly valued type of reward system for top-performing employees and most directly align individual performance with business results. Incentives can be used at all levels to improve financial performance and align employee behavior with business goals. This approach also is cost effective because it is not built into fixed costs, but can vary depending on business results and individual contributions. Companies are finding ways to align their total rewards approach with performance in real time.

"We know that the next big step in our new system for rewarding performance will be to link our company's business strategy to our rewards objectives," said Celeste LaRue, manager of HR for Canon Development Americas. "We will have to make that business strategy visible and clear to people at every level in the organization."

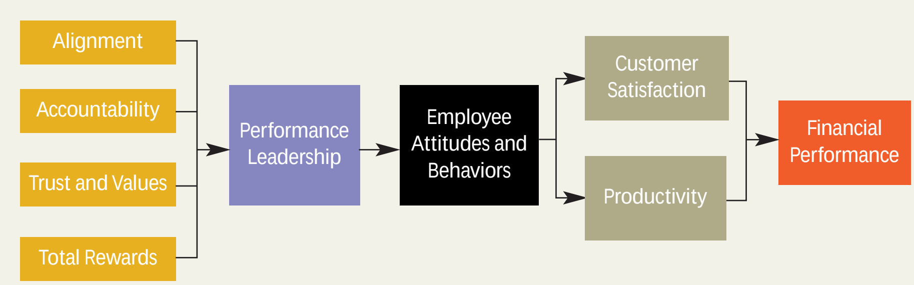
FIGURE 4: PERFORMANCE LEADERSHIP: BIG IMPACT, POOR EXECUTION

Practice	Effect on Shareholder Value	% of Associates Who Say Their Firms Do This Well
Company promotes the most competent employees.	Increase	24%
Top performers are paid better than average performers.	Increase	30%
Company helps poor performers improve.	Increase	24%
Company terminates poor performers whose performance does not improve.	Increase	26%

The higher a company's HCI score, the higher its shareholder value. In other words, the better an organization manages its human capital, the better its returns for shareholders. The HCI study shows which performance leadership practices have an impact on the bottom line, and the *2002 WorkUSA* survey shows the percentage of associates who say their organizations do this well.

Sources: Watson Wyatt's *WorkUSA 2002* and *Human Capital Index* 2001/2002

FIGURE 5: PERFORMANCE LEADERSHIP IN ACTION



Transforming the Processes

At its core, the leadership promise and opportunity for performance management is about transforming the business structures and processes by which organizations support inefficient and ineffective performance management systems. Like all deep change, the transformation occurring in performance management is slow. But it is profound and will result in a new neural system for productivity improvement and enhanced financial results.

The organizations making the transformation to performance leadership are using technology to assist with alignment and measurement. "An organization has to strive for efficient data collection and reporting processes," said Leslee Perlstein, senior vice president at E! Networks. "This involves fast collection of data from different sources and the ability to efficiently generate custom reports on performance that contain relevant information compiled from that data. The enabler is technology."

FIGURE 6: CREATING EMPLOYEE LINE OF SIGHT

	High Effectiveness	Medium Effectiveness	Low Effectiveness
Communicates openly to employees about matters that affect them.	88.2%	62.4%	47.2%
Shares business plans and/or goals with employees.	81.2%	40.9%	30.3%
Shares financial information with employees.	78.8%	37.6%	33.7%
Leaders consistently communicate company information to employees.	60%	22.6%	15.7%

Many traditional performance management programs focus on the mechanics of filling out appraisal forms to document performance. In some cases, these programs train managers on how to set *smart* goals and give feedback. However, these programs do not go far enough to affect the business. Rarely do companies ask if the smart goals are the right goals. While organizations need the mechanics of effective performance management, they also need performance leadership to drive financial results.

By focusing on the four principles of performance leadership, HR professionals can better meet the three CEO challenges posed at the beginning of this article. As with all transformations, designing and implementing the change to performance leadership requires tailoring the process to the specific situation of your organization. WS

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