Summary: How can you tell that your performance management system is not working as well as it should? Here we describe three key indicators that can provide you with clues that your performance management system is not reaching its potential. We provide examples of each based on our experiences and briefly describe how the issue can be addressed. The three signs we discuss are: 1) employees aren't performing some aspects of their jobs; 2) employees' performance is lackluster; and 3) you are losing your top performers.

Quick Look:

- The three key indicators of performance management problems are: employees aren't performing some aspects of their jobs, employees' performance is lackluster and you are losing your top performers.
- Letting employees participate in the determination of their performance goals can go a long way in getting them to accept them as legitimate and doable.
- When poor performers earn as much as good performers, other things being equal, it is seen as inequitable and unfair, particularly by the good performers.

Three Indications Your Company Has Performance Management Issues

By Steve Werner, Ph.D. and Naomi Werner, University of Houston

Performance management is a critical component of a total rewards system. Having performance goals, tying pay to performance, providing employees constructive feedback, and an effective performance appraisal system are all needed to get the most out of your total rewards. But, what if you have all of these in place, how do you know you are getting the most out of them? It's not enough to just have the components of a performance management system in place, they have to be well-designed and well-implemented.

Performance goals, for example, need to be carefully designed. To maximize motivation the goals should be specific and difficult, but achievable. They should also have employee buy-in. Letting employees participate in the determination of their goals can go a long way in getting them to accept them as legitimate and doable. Employees should also be getting frequent feedback on how they are doing with respect to achieving those goals. Feedback should be given in planned sessions that focus on solving problems and planning for the future.

So how do you know if one of these components of a performance management system are not working? There are a number of indicators which can provide you clues that your performance management system needs some improvement. Although these signs can occur because of problems in other HR areas such as training or selection, the most likely offender is your performance management system. The three signs we discuss are: 1) employees aren't performing some aspects of their jobs; 2) employees' performance is lackluster; and 3) you are losing your top performers.

Employees Aren't Performing Some Aspects of Their Jobs

When employees aren't performing some aspects of their jobs, it is likely that there is a performance management problem. Even more specifically, the pay for performance component of the performance management system is most likely to be the culprit. If there's one thing we know about pay for performance, it's that employees will do what you're tying pay to. If bonuses, raises, or other rewards are only tied to some aspects of the job, you can expect the other aspects to get largely ignored. Using comprehensive performance measures or multiple measures that capture all aspects of the job will help resolve this issue.

However, using multiple performance measures to capture all aspects of the job can lead to other complications. If some measures are perceived to be easier to achieve or if the pay-off for some measures dominate others, you can expect employees to focus on them. Employees are more likely to spend time on easier to achieve measures than on those perceived to be harder to achieve. They are also more likely to expend their efforts on measures that lead to greater rewards than on measures that lead to fewer rewards. So if some aspects of the job aren't being done, even when the performance measure captures them, it may be that some tinkering of the goals or pay-off weights attached to that aspect is needed.

For example, one energy firm had bonuses for sales personnel tied to a number of different target goals related to both their quality of customer service as well as quantity of sales. The company found that sales people were focusing on the quality measures, but not the quantity measures. Some research revealed that the quantity targets were perceived to be unrealistic; that is, almost none of the salespeople thought they could ever achieve them. So the salespeople focused on achieving the quality targets and ignored the others. By focusing their efforts on quality targets, they believed they were maximizing the bonus money they would receive since focusing on the quantity targets seemed like a lost cause.

To address this problem the company adjusted its incentive program targets. Management worked hard to create targets that were difficult, but still attainable. They also tried to make sure that the targets were equally difficult. Because they were perceived to be equally difficult and because the company believed they were equally important, the pay-outs were equally weighted. Management also ensured that the targets were based on measures that the employees had direct control over. Although the targets were determined by management, salespeople had input in their development. This not only increased the buy-in of the salesforce, but also provided additional information to management, helping them determine appropriate target levels. Almost immediately after implementing the new targets, managers noted that the salesforce was focusing on quantity as well as quality.

Employees' Performance is Lackluster

If you have numerous employees performing poorly, it almost certainly signifies some kind of management or systemic problem. It could be industry related, related to job design, related to training or selection, or any one of numerous other issues. It could also show management's failure to motivate the workforce. Effective performance management, which includes a well-designed and well-implemented pay-for-performance system, can go a long way to motivate employees. Although many pay for performance systems have problems in design or implementation, overall, pay-for-performance plans tend to improve the performance of individuals and organizations as a whole.

Merit systems, for example, can be a long-term motivator for employees. Yet, there are numerous problems that can emerge. Does the performance appraisal system clearly distinguish between good, average, and poor performers? Is the firm able to give substantially higher raises to the best performers? Are the raises large enough to have a motivational effect on employees? An ineffective merit system may be worse than not having one at all since the organization is incurring greater costs but getting little in return.

For example, one service firm found that its productivity was substantially lower than its competitors. Managers believed that employees had little motivation, which was reflected in the mediocre actual performance of most employees. Under close scrutiny, it was discovered that the performance appraisal system was inadequate, with most managers giving all their employees the same inflated ratings. Little distinction was made between high and low performers, with most scoring between 3.5 and 4.5 on a 1-5 scale with the vast majority receiving 4s. Performance appraisals had become a formality which most managers devoted little time to. The appraisals were not used for any developmental feedback, and were largely ignored. Although the scores were technically tied to raises, the differences in raises between the highest and lowest performers were miniscule. Thus, there were no rewards, monetary or social, for performing well.

A revamped performance management system was introduced. This included a new appraisal system, which incorporated more precise rating scales, manager training, and multiple raters. Managers' own performance score was now partly based on the quality of their performance management of their subordinates. Because it was expected that the revamped system would encounter some resistance, employees were involved in its development from the beginning. It became clear that top management supported the initiative, and that managers would be held accountable for the accuracy of their ratings. The new system substantially improved the variability in the ratings, better reflecting actual performance, with ratings ranging from 1 to 5. The mean was also lower at 3.2. This provided the company with a better performance measure to tie merit raises to.

You're Losing Your Top Performers

Not paying for performance at all can lead to this disastrous outcome. People expect good performers to earn more than poor performers. When poor performers earn as much as good performers, other things being equal, it is seen as inequitable and unfair, particularly by the good performers. Thus, counterproductive work behaviors, decreased performance, and outside job searches can then be expected from this highly valuable group. Because high performers are likely to be marketable even in this difficult economic environment, they will eventually find jobs in organizations that will pay them for their high performance.

This is not true for the poorer performers. They are less likely to be looking for jobs, because they are happy at a place that doesn't reward performance. So, not paying for performance leads to unhappy high performers and satisfied poor performers. This is the exact opposite of what would be desirable for the bottom line. You want to keep the "talent" happy and motivated, and if the poor performers leave this may be thought of as "positive turnover". A good pay-for-performance system can do just that.

For example, one company gave employees across-the-board raises only. Although they had a decent performance appraisal system, the system was used for developmental purposes only. The scores were not tied to any formal rewards. Incentives were tied to group performance measures and raises had no individual merit component. The company noticed that the high performing employees were the ones most likely to leave. The high performers were unhappy that employees who were not working as hard as they were, were getting paid the same. They were also upset that although they were the ones largely responsible for the achievement of group goals, the poor performers were capitalizing on the group bonuses the same as they were. The high performers were able to find jobs at other companies where their upside potential was substantially higher if they continued to excel.

So the company revamped its incentive system by adding an individual-based performance measure to the incentive plan, incorporating appraisal scores in raise determinations, and adding a recognition program. The high performing employees were highly satisfied with the new program and their turnover rate dropped quickly. The poor performers were unhappy with the new system. Some left the company, while other improved their performance to maximize their bonuses. Overall, the company believed that the new system was a considerable improvement.

Conclusion

If you have a performance management system and you notice any of these indicators of a poor performance management system, you should take action. You may notice one, two, or all three indicators. The more of these that you notice, the greater the problem, and the faster action is required. Although the indicators we have discussed could be caused by other factors, the performance management system is the likely culprit.

A poor performance management system may be worse than not having one at all because of the added costs with little benefit. However, we do not intend to imply that not having a management system is okay. Not having performance goals, not tying pay to performance, not providing employees constructive feedback, and having no performance appraisal system means that your employees are almost certainly not performing up to their potential. However, just throwing a plan in place is not likely to generate great improvements. Like the compensation system itself, the performance management system has to be carefully designed, carefully planned, tailored to the organization, supported by top management, and involve employees to get their buy-in.

About the Authors

Steve Werner, Ph.D. is a Professor of Management in the Bauer College of Business at the University of Houston. He can be reached at 713-743-4672 or swerner@uh.edu.

Naomi Werner is a Lecturer for the Department of Management in the Bauer College of Business at the University of Houston. She can be reached at 713-743-4679 or nwerner@uh.edu.