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whitepaper

Performance Management: Impacts and Trends

Written and prepared by:
Roger Sumlin, Senior Consultant
Performance Management Practice

Recent studies have identified trends in effective performance management systems and determined the impact of these systems on organizational success. The messages from these studies are dramatic: Performance management is an important business system; it makes a difference in organizational performance; approaches to performance management are changing; and senior managers must be attentive to the performance management systems in their organizations.

This body of research is useful to anyone designing and implementing a new performance management system and equally beneficial to those trying to prove the value of effective performance management.

This paper reviews six recent performance management studies and organizes their key findings into two groups: Performance Management Impact on Organizational Success and Performance Management Trends/ Best Practices.

The first group substantiates the importance of performance management; the latter group aids the practitioner seeking the characteristics of successful systems. Two studies, one by DDI in 1997 and one by Hewitt in 1994, address and appear in both areas—organizational impact and trends.

Performance Management Impact on Organizational Success

1997 Study by DDI

Performance Management Practices is the most recent performance management study. It proves that successful organizations realize that performance management is a critical business tool in translating strategy into results. The CEOs in the majority of the 88 organizations surveyed say their performance management system drives the key factors associated with both business and cultural strategies. Some key findings of the study follow.

Organizational Impact

Performance management systems directly influence five critical organizational outcomes: financial performance, productivity, product or service quality, customer satisfaction, and employee job satisfaction.

When performance management systems are flexible and linked to strategic goals, organizations are more likely to see improvement in the five critical areas.

Team objectives, nonmanager training, appraiser accountability, and links to quality management are the specific practices most strongly associated with positive outcomes.

Supplemental Survey—CEO Ratings

A supplemental survey in this study sought CEOs' perceptions of their organizations' performance management systems.

Sixty-three percent of CEOs believe their performance management system drives the key factors associated with business strategy. Seventy-nine percent say their system drives the cultural strategies that maximize human assets.

When CEOs realize the value of performance management in driving business strategy, overall system effectiveness is significantly higher.

The success of performance management and its effect on business and cultural strategies depend heavily on senior-level support.

1996 Study by Wm. Schiemann & Associates

This national survey of a cross-section of executives concluded that measurement-managed companies—especially those that measure employee performance—outperform those that downplay measurement. The research studied 122 organizations making between $27 million and $50 billion in sales.

A higher percentage of measurement-managed companies were identified as industry leaders, as financially in the top third of their industry, and as successfully managing their change efforts. This last area implies that measurement-managed companies tend to anticipate the future and are likely to remain in a leadership position in a rapidly changing environment.

The research examined performance in six strategic performance areas deemed crucial to long-term success:

- Financial performance
- Operating efficiency
- Customer satisfaction
- Employee performance
- Innovation/Change
- Community/Environment

The findings revealed that the biggest measurement area separating successful from less successful firms is employee measurement. Successful industry leaders simply do a better job than nonleaders at measuring their workforce, which, the study says, is where real change is won or lost.

Study data point strongly to four mechanisms that contribute to the success of measurement-managed companies:

- *Agreement on strategy*. Ninety-three percent of the measurement-managed firms reported agreement among top management on strategy, versus only 37 percent of the nonmeasurement-managed organizations.
- *Clarity of communication*. Good communication demands a clear message, and measurement provides a common language for communication.

- *Focus and alignment of efforts*. Measurement-managed companies reported more frequently that unit performance measures were linked to strategic company measures and that individual performance measures were linked to unit measures.
- *Organizational culture.* Compared to nonmeasurement-managed organizations, measurement-managed companies more frequently reported strong cultural elements, such as cooperation and teamwork among the management team, a greater extent of employees self-monitoring their own performance, and a greater willingness to take risks.

1995 Study by Yankelovich Partners for William M. Mercer

The 1,200 workers surveyed said that on average they could improve their daily output by at least 26 percent if only they weren't hindered by lack of —in order of importance—direction, support, training, and equipment. One in four said they could raise productivity by 50 percent. An effective performance management system delivers the direction and support workers need.

1994 Study by Hewitt Associates

The Impact of Performance Management on Organizational Success substantiates that performance management systems can have a significant impact on financial performance and productivity. The study used the Boston Consulting Group/HOLT financial database to track the financial performance of 437 publicly held U.S. companies from 1990 through 1992. Researchers first compared organizations that had performance management systems with those in the same industry that did not. The researchers then compared the financial performance of the organizations having performance management systems (47 percent) to see how those organizations fared before and after implementation.

The study results showed that:

- Companies with performance management programs have higher profits, better cash flows, stronger stock market performance, and a greater stock value than companies without performance management.
- Productivity in firms without performance management is significantly below the industry average, while productivity in firms with performance management is on par with the industry average.
- Companies with performance management significantly improved their financial performance and productivity *after* implementing performance management.

In 1995 the researchers conducted additional analysis of the study data. This longitudinal research focused on the following three financial ratios that the researchers say are excellent indicators of a company's overall financial strength:

- Stock return to market index
- Price to book total capital
- Real value to cost

Companies with performance management achieved higher ratios than those without in all three areas.

Performance Management Trends/ Best Practices

1997 Study by DDI

In addition to looking at impact on organizational success as reported in the first section, this study also investigated organizations' current performance management practices and compared the results with those from DDI's 1993 study (described later in this paper).

Most Frequently Used Practices

- Fifty-one percent of organizations frequently train managers in applying performance management systems, and 22 percent frequently train nonmanagers.
- Thirty-eight percent of the organizations frequently use competencies in their performance management systems.
- Approximately 20–25 percent of organizations frequently use peer input, customer feedback, and input from direct reports.
- Twenty percent of organizations frequently include team-based objectives in individual performance plans. Team appraisal, in which team members or peers actually appraise one another, is less common.
- For rating techniques organizations rely primarily on overall ratings, summary statements, and numerical ratings.

Changes in Usage

In 1993 DDI's survey of performance management practices measured current and predicted usage for 12 of the practices measured in this study. The following highlights the key changes in usage between the two studies:

- Training for both managers and nonmanagers in performance management *doubled* in four years.
- Forced rankings (i.e., the use of a predetermined percentage of ratings distribution) *decreased by more than 300 percent* since 1993.
- Team-based objectives have become more common.
- The most common rating tools—overall ratings and summary statements—are used even more frequently than they were four years previous.
- Different forms of performance management input—particularly peer input—have become more common.
- Respondents to the 1993 survey predicted a large increase in the use of team appraisal. That prediction proved to be off target.

Effectiveness

Although some system qualities such as employee involvement and flexibility were more prevalent, they were not necessarily the qualities most predictive of system success. The following system qualities and practices had the strongest relationship to overall effectiveness.

- *Alignment*. Aligning performance management to support organizational goals and integrate with other systems proved to be the most critical differentiator in system effectiveness. However, it was the least common quality of the performance management systems in the sample.
- *Accountability and training*. The most successful performance management systems required training in using the system, established clear accountability for the people using it, and focused on competencies.

1994 Study by Wyatt

This study focused on identifying *best practices* in performance management by examining the systems of a select group of 37 companies recognized for financial success and innovative resource programs.

What emerged from the study is not a single best system, but a set of best practices that can help focus the process of designing, implementing, and monitoring performance management. Distilled, the best practices share a handful of traits:

- Full alignment with other parts of the organization
- Simplicity
- Flexibility
- Decentralized control
- A measurement process
- Employee development

Other findings include:

- *Alignment with business objectives, strategy, customer needs*. Alignment is central to performance management. Companies reinforce the following most important behaviors and results when they link performance measurement to key areas: customer needs, the company's mission and values, business improvement initiatives, and human resources.
- *Decentralized control.* Performance management works best when the process is not highly centralized. Allowing individual business units the flexibility to customize the system fosters a greater sense of employee ownership.
- *Greater links between pay and performance.* All companies in the survey link pay and performance management through merit systems and sometimes through incentives.
- *Feedback from multiple sources*. Leading businesses are building 360-degree or multiperspective feedback into their systems. These include self-assessment and assessments from peers and subordinates, and customers are increasingly brought into the assessment process.
- *Simplicity*. Simple performance management systems are easier to use, offer greater flexibility, and are easier for employees to understand, which fosters faster acceptance by the employees.
- *Measurement of results*. Many managers look to their organization's value statements for key behaviors or competencies. Clearly communicated business strategies drive the results measures.
- *Senior management involvement.* By participating themselves and making sure that direct reports participate, senior managers can help ensure that the system works.

1994 Study by Hewitt

This study analyzed data from 18 companies in which senior managers and human resource executives were particularly satisfied with the results of their performance management systems. The study found that those programs shared several characteristics:

- *Implementation at the top.* Senior managers helped design and implement the program and used it with those reporting directly to them.
- *Simple process.* The performance management process was relatively simple and was integrated into the daily work process.
- *Reasonable number of goals.* The number of goals was limited to four or five, with bonuses

and incentives to reward those who achieved their goals.

- *Additional feedback.* Annual reviews were supplemented by regular informal feedback.

1993 Study by DDI and Society for Human Resource Management

The national study *Performance Management: What's Hot—What's Not* examined trends in performance management practices, people's satisfaction with their organization's current systems, and the bridges and barriers to effective management.

The study involved 1,149 people, including managers (56.8 percent) and nonmanagers (42.2 percent), representing 79 companies.

Major study findings regarding people's *satisfaction* with their current system revealed:

- *Feedback and Coaching,* considered the heart of an effective performance management system, fared the worst. Respondents reported they receive feedback and coaching too infrequently, and when they do, it is unbalanced and nonspecific.
- *Performance Planning* got the highest marks. Results from this section show that organizations are getting better at clarifying goals and linking them to organizational strategies, although there is room for improvement. Managers reported a much stronger sense of ownership and involvement in establishing their performance plans than did nonmanagers.
- *Performance Review* offered a good news/bad news scenario. Most participants consistently receive an annual review, and most viewed theirs as participative and covering both strengths and areas for improvement. However, most respondents indicated they prepared little, suggesting that the assessment process might not be participative. And reviews still emphasize results instead of results and the skills and behaviors used to achieve them.
- *Outcomes,* defined as results or overall feelings after participating in the performance management system, received mixed responses with no areas of great satisfaction. Respondents indicated significant frustration about pay and promotion decisions not being clearly linked to the performance management system.

Regarding the top *trends,* respondents think organizations will:

- Continue to adopt the already-popular practice of using essays to describe an employee's overall performance.
- Give managers more training in performance management.
- Tie performance management more closely to quality improvement efforts.
- Hold managers accountable for using performance appraisal effectively.
- Educate employees about their companies' performance management system to help them manage their own performance.
- Ask internal and external customers to contribute to appraisals.

Conclusion

This growing body of research finds for us characteristics and practices that have proven successful for others. In doing so, it helps guide us in improving our own performance management system. Some of the research also provides the hard data we need to know that performance management is an important business system—one that affects our organization's bottom line and is worth our efforts to make it right.

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