Reflektive

The Ultimate Guide to Performance Ratings

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Ultimate Guides by Reflektive

In our Ultimate Guide series, you'll learn how to navigate the changing world of performance management. These comprehensive guides cover topics vital to HR leaders and senior executives committed to innovation in today's workforce.

Introduction

Performance ratings have recently come under fire. But at established companies, some executives are hesitant of leaving ratings behind. With them goes a formula for compensation updates and an objective performance measure that shields a company from lawsuits.

This, at least, is the argument keeping ratings intact in many organizations. Meanwhile, smaller startups and industry leaders such as Goldman Sachs are pivoting away from a traditional performance management process, and getting rid of ratings completely.

It is important to understand the role ratings play in employee experience, including motivation, engagement and retention. It's also time to take a closer look at how ratings meet the objectives for which they are intended.

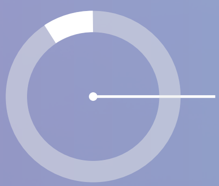
History of Ratings

Performance ratings are embedded in history. There is little documentation to when corporations adopted the practice, but they were used by the U.S. federal government in 1912's First Law on Appraisal, when a uniform efficiency rating system was established for government workers. A three-tier rating system became required in 1950.

The Civil Service Reform Act of 1978 mandated pay-for-performance, but 1988 report "Can Pay for Performance Succeed in Government" found no evidence that pay-for-performance improved organizational results. Still, the assumption workers are extrinsically motivated persisted and the myth holds true at many companies today.

It's easy to look at your workforce and assume efficiency and effectiveness will align with rewards. But data continues to show that is not the case.

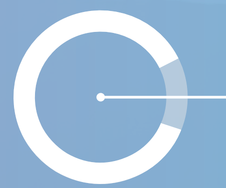
Research by Eli Lilly reveals the impact of ratings on employee motivation. In the month following performance ratings:



For employees given the top rating, engagement dropped

15%

before improving later in the year



For employees rated lower on the scale, engagement dropped by

85%

For this reason, many managers soften their ratings to avoid the negative impact, causing ratings to be unreliable and inaccurate. This causes problems down the line when it is impossible to fire an employee who's consistently been rated a 4 out of 5.

But before giving up ratings entirely, consider the one way ratings serve employees: They communicate how rewards are to be determined.

Why Companies Use Ratings

Employees today are taking responsibility for their own career advancement. Employees want to know when they'll be up for promotion and how they can make it happen. If merit raises do not follow a formula, there are accusations of favoritism by managers. Thus, a rating can provide necessary context for employees.

Traditionally, employees had to wait until the end of the year for their annual review to hear about compensation, and along with it, get feedback on how they were doing. One solution is the weekly one-on-ones and other real-time development that's become popular at modern companies. The benefit is that employees don't need to wait for their "letter grade" at the end of the year. Companies that adopt real-time feedback will find employees are less reliant on ratings.

Additionally, real-time feedback that is documented digitally protects companies from litigation. Appraisals with specific examples are the most useful in defending a discrimination claim, and these examples are easier to document with real-time feedback than with an annual evaluation which is subject to recency bias. A rating without these specific examples does little to protect an employer.

The Changing Workforce

As a student, you may have been advised to think about what you would do if you had a million dollars — and your answer should determine your career.

There is truth to this sentiment. A sales director may be drawn to the role because she enjoys networking, while an airline front desk agent might enjoy working with logistics. Underneath each job is a set of motivations. We all know we enjoy our day more when we can connect what we enjoy to what we do for work. So, why do we assume our employees are only motivated by pay?

A workforce is not motivated by pay alone. So the key utility of ratings — an objective driver of a compensation formula — falls apart.

Additionally, employees today enjoy increased job mobility. Changing business goals mean employees also shift roles (and even careers) many times in a lifetime. Opportunities for learning and development become more important than pay. The rating scale based on a job description loses relevance.

Companies need to evaluate performance not based on quotas met or a static set of skills. A more fluid, agile measure is required to measure performance of knowledge workers — and a measure that drives action, rather than detracting from motivation.

The Impact on Motivation

Performance ratings intend to fairly dole out rewards including promotions, raises and bonuses. In reality, they can create a cycle. Top performers move up, while average as well as underperformers are demotivated, further reducing their contributions to the company.

Good managers can give helpful feedback along with ratings to help their employees improve and perhaps score better the next time. But, neuroscience reveals that employees shut down to this feedback because a rating conversation is perceived as a social threat.

Employee Anxiety

Annual ratings create a lot of anxiety for employees. Imagine you are an employee that hasn't received much feedback throughout the year. Now suddenly during the annual review, you receive a lot of negative feedback that comes as an surprise. Instead of hearing the feedback during the year and giving you a chance to improve, you are instead given all this feedback in an evaluation that is tied to your compensation.

As a result, you are defensive, and deflect the feedback rather than being receptive to it. Instead of creating an environment that is conducive to learning, you are in an environment riddled with anxiety and defensiveness – as a result you are not receptive to feedback. Not only that, you are now unhappy with the annual review process as a whole.

Manager Bias

Recency bias is the term given to a bias that causes managers to place more weight on an employee's recent performance instead of looking at the scope of an individual's work over the year. Even the best managers struggle with recency bias as it's an impossible task for managers to accurately remember what an employee has done over twelve months. Because of this, and even with a manager's best intentions in place, ratings are often inaccurate and mostly reflect the last few months of work rather than the full evaluation period.

The Halo Effect

A result of employee anxiety is the halo effect, in which managers rate their reports moderately to avoid having difficult conversations. You can see where this is going.

When it comes time to cut an employee, organizations find their hands are tied because this employee has been given positive reviews and they lack credibility or evidence for poor performance. A slew of negative feedback and disciplinary measures leading up to a termination will not hold up in court in discrimination cases that are becoming more and more common.

Conversely, real-time feedback allows managers to hold critical conversations with employees apart from the pressure (and cognitive load) of a rating, and documentation of these specific examples will provide more value to the company in case of litigation.

Numeric vs. Non-Numeric Ratings

Many companies that are reworking their performance management have stopped short of getting rid of performance reviews by first eliminating ratings. Others are evolving away from ratings by eliminating numeric ratings, and instead having managers select adjectives or rate employees on a scale from "exceptional" to "needs improvement," instead of 1 to 5.

Numeric ratings, at first glance, appear to provide objectivity. The problem is, they are especially susceptible to manager bias. Research shows that ratings are more reliable in reflecting a manager's opinions than the employee's competencies. For example, a manager's rating on time management would reflect how important the manager felt time management was, rather than the employee's relevant performance.

The move to non-numeric ratings removes much of the anxiety associated with being given a score. But, many of the issues hold true. Anything less than a top score demotivates employees. Despite what you call these evaluations, employees see through the system and still know they're being rated.

How to Evolve Performance Management

Ratings are a cornerstone of many performance management systems. Recognizing the bias and inaccuracies in ratings does not mean they should be eliminated immediately. Launching real-time feedback enables employees to get the developmental coaching they need — plus, an end-of-year rating doesn't come as a surprise because feedback has been given all year. Documented feedback from throughout the year also means companies can phase out poor performers and know the necessary supporting data is on hand. Companies that launch real-time feedback will find ratings become less problematic when kept, and in some cases, can be eliminated completely.

COMPENSATION

When ratings are removed, one of the first questions that comes up from administrators and employees alike is how compensation will be handled. Ratings, for better or worse, provide a structured way to distribute raises, bonuses, and other compensation increases. When ratings are taken away, how can you ensure that the system retains your talent and gives employees the extrinsic rewards they deserve?

Without ratings, managers are tasked with determining compensation increases and promotions for members of their team. Empowering managers with this key performance motivator is a good thing, but only if the manager is actively managing their team.

RATE ON GOALS, NOT SKILLS

Agile goal management, including OKRs and S.M.A.R.T. goals, are a performance management format that fit today's changing business environment. They allow employees to align with the company's mission and objectives. A quarterly goal check-in can take the place of a performance review, giving employees and managers a time to discuss goal progress. Employees can document goal progress with a rating or a percentage that allows HR to see companywide progress. Because the conversation is forward-facing, managers and employees are able to have a forward-facing conversation with less of the anxiety associated with a review.

SEPARATE DEVELOPMENTAL CONVERSATIONS

Research shows that a social threat activates the same part of our brain as, say, putting one's hand on a hot plate. That explains why performance reviews can induce so much anxiety — the brain is literally lighting up as if one's well-being is in danger. But, the objective of a manager providing feedback is to improve an employee's performance.

The developmental conversation should be separated from a conversation around ratings. The rating may be done at the end of the year and influence compensation. Companies must require managers to discuss developmental feedback with employees earlier in the year.

For example, weekly one-on-one meetings make feedback a habit and ensure employees get the guidance they need. Quarterly check-ins also provide a more frequent feedback cycle. With real-time feedback in place, employees are able to find intrinsic motivation in their role and perform at full potential.

Contact Us For More Information

hello@reflektive.com

reflektive.com/demo