10 minutes on...

Ending performance ratings: it feels so good, but is it sustainable?

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Companies are abolishing performance ratings - should you?

Performance ratings are under fire. The process of rating employees certainly has negative implications, which has led some companies to abolish their ratings altogether. Early results indicate an uplift in employee engagement.

Is this something you should consider? Possibly.

If you've been following the press lately, it feels like everyone's getting rid of ratings, or rid of the annual performance review. While this may be the right answer for some, for most it is a red herring – it is how performance management is carried out that really counts.

Companies need to be careful not to throw the baby out with the bath water. Without the year end rating, the danger is that the distribution of pay and bonuses can become even more of a dark art, as shadow systems evolve without proper governance and infrastructure behind them. Also, many employees still report appreciating the clarity that an effective formal assessment provides. In fact, only 18% said changing their company's performance assessment approach was a priority, with 51% instead prioritising feedback and the coaching capability of management[1].

Before committing to change, we encourage you to:

- consider the underlying issues that are leading companies to abolish their ratings and whether or not your issues are the same.
- consider some important "prerequisites to removing performance ratings".
- decide whether this approach, or other changes, will best drive change in your organisation.

Prerequisites to removing ratings

- ❑ You have a culture that supports frequent, meaningful conversations and quality feedback in the absence of an annual ratings process.
- ❑ Your managers are effective coaches or you have a plan in place to address any coaching deficiencies.
- ❑ Your pay and promotion processes do not solely rely on performance ratings.
- ❑ You have robust processes in place to prevent biases developing in the absence of performance ratings as a reference point.

1. Captured as part of PwC's research: Performance Management: Change is on the way, but will it be enough? (2015)

Is abolishing performance ratings the solution to everything we hate about performance management?

Several companies have abolished performance ratings, citing some well accepted limitations of rating processes

When abolishing performance ratings, companies cite consistent change catalysts:

- Managers are over reliant on ratings as feedback, rather than engaging in quality conversations.
- The focus on ratings and compensation outcomes crowds out development discussions.
- The process is costly and time-consuming.
- The process is focused on the minority at the top or bottom of the performance curve, not the majority.
- There is a need for 'real-time' feedback, as well as technological advances that now enable this.

These criticisms are reinforced by neuroscience research, which indicates that the mind responds with a "fight or flight" response to performance ratings, inhibiting learning and development[1].

Ratings are still the majority practice (by far)

PwC Australia research from March 2015 found that all surveyed companies were using performance ratings (n = 27)[2]. Similarly, PwC UK found that just 5% of companies were actively considering dropping ratings (n = 97)[3]. As such, the movement away from ratings is not significant as yet.

These companies also grapple with the problems associated with ratings. Rather than abolishing ratings however, many are working to address the issues within the current framework, acknowledging that the problems are mostly related to execution as opposed to the system itself: more focus on real time feedback, enhancing coaching capability, and using technology as an enabler.

Companies that have recently abolished performance ratings (or intend to do so):

- Microsoft
- Deloitte
- Adobe
- Motorola
- Cargill
- Expedia
- Accenture
- NAB

Top tips

- *Agree a clear intent for performance management, obtaining consensus on a shortlist of just two to three objectives.*
- *Assess the role of ratings and performance discussions:*
  - *Are performance discussions being used to identify and manage underperformance so that only the remaining good performers share in the experience and rewards?*
  - *Are performance discussions being used to truly differentiate the experience and reward of the highest performers from the rest?*
- *Assess whether ratings support the culture and performance objectives you're trying to achieve.*

1. Strategy& – Kill your performance ratings (2014)
2. PwC – Performance Management: Change is on the way, but will it be enough? (2015)
3. PwC – More companies planning to ditch annual performance reviews and ratings, but will employees benefit? (2015)

Regular, quality feedback is what's missing – ratings may be an inhibitor but removing them is not the enabler

Some managers assert that removing ratings will allow good management practices to emerge. However, this is a risky assumption considering the top performance management issues raised by companies were not in relation to the system, but to "execution":

- 69% of companies see line managers not prioritising performance management conversations and feedback as an issue.
- 81% focus on process rather than quality of discussion and outcomes.
- 63% of companies say line managers don't have the willingness or the ability to objectively assess and differentiate performance.
- just 15% of companies say their execution is "highly effective"[1].

Manage risk by ensuring your people have the capability and structure to execute if ratings are removed

While ratings don't prohibit year-round feedback, the presence of semi-annual or annual checkpoints can anchor managers to delayed feedback times. However, removing these checkpoints can expose management capability issues.

Of the high profile companies removing performance ratings, most are promoting year-round feedback. They support this with structured training, technology and process changes.

As feedback becomes more timely, its structure becomes key (e.g. its link to goals, whether it is actionable). Without good structure, low quality feedback can emerge (e.g. "likes", feedback not relevant to your growth objectives), adding tremendous noise to performance discussions without enabling performance improvement.

It's important to note that it isn't the "system" that has prevented more frequent or quality conversations. As such, your approach should overtly address the root cause of the issues you face, lest you be seen to be applying a band aid for a snake bite.

Top tips

- *Create reasons for more frequent feedback sessions e.g. monthly performance/development topics.*
- *Performance ratings don't mix well with development conversations. Separate them: different timing, different labels, potentially even different managers.*
- *Building capability is costly, so consider how to scale and apply it across the different parts of your organisation.*
- *Consider the role both leaders and employees play in performance management effectiveness and invest accordingly.*

Case study: Adobe's "Check-in"

In 2012, Adobe abolished the performance ratings and introduced the 'Check-in'. Every three months, an employee or manager may request a 'Check-in'. In preparation, colleagues provide feedback on the employee's performance. The 'Check-in' is then a conversation around the results of the feedback, focused on performance improvement rather than a dispute about compensation or rankings.

1. PwC – Performance Management: Change is on the way, but will it be enough? (2015)

If performance ratings are to go, have a valid alternative with which to make pay decisions

For many companies, performance ratings are a key input when determining incentives, fixed pay increases, promotions, and key talent lists. Abolishing ratings can have a significant impact on these processes.

Separating performance from rewards should be done carefully lest bonus outcomes become a proxy rating

Companies removing ratings should consider one of six main approaches to their reward decisions.

Alternative approaches	Risks
1. Apply equal bonus outcomes for all: while employees may have different target incentive amounts depending upon their role, they all scale up or down proportionately based only on company performance.	Requires a different value proposition to be created for top individual performers and is particularly challenging in sectors that tend to have high amounts of variable pay. To still drive a performance focus, other elements of the employee value proposition need to be compelling.
2. Sort employees into two bonus outcome categories – those performing, and those who aren't. As with alternative 1, pay equal bonus outcomes but only to those employees in the 'performing' group.	Risks are similar to alternative 1, although slightly reduced as top performers are at least differentiated in the aggregate from under/or average performers. Even so, the equal/shared performance outcome is likely to affect the motivational impact of the bonus (PwC research[1] found 60% of employees would stop being motivated by bonuses based on team size >5, with 90% losing motivation when team size >10).
3. Continue to operate a differentiated bonus approach: employees are categorised or assessed relative to one another i.e. effectively a performance rating is applied 'behind the scenes', resulting in differentiated pay outcomes. Only the bonus result is communicated however.	Likely to result in bonuses being a proxy rating for employees, negating the benefit of removing ratings in the first place and possibly creating more mistrust as ratings become less transparent. Biases could be exacerbated in the absence of any calibration/moderation activity.
4. Provide managers a reward budget and discretion to pay on-the-spot bonuses: Devolve variable remuneration decisions to the team level, paying bonuses to reward good performance as it occurs.	Subjectivity will be more influential on reward outcomes and less data with fewer 'eyes over it' may take us a step backwards in terms of gender pay parity and cultural biases.
5. Allocate bonuses based on 'peer' points assigned to each employee throughout the year: employees start each year with a certain number of 'values points' that they can assign to any peer/boss/subordinate to acknowledge a positive display of values/behaviours.	Requires careful monitoring of who is allocating points to whom and why, to prevent a "point for point" situation or employees "paying" their friends.
6. Pay fixed rewards only: remove pay-for-performance structures altogether.	Market competitiveness may be compromised for large listed organisations as it is still the norm to allow employees to participate in a company bonus plan.

1. What are you really paying for? Improving return on reward investment

If performance ratings are to go, have a valid alternative with which to make pay decisions (cont'd)

Top tips

- *Align your pay approach to your culture and performance objectives.*
- *If adopting a differentiated pay approach:*
  - *Structure your processes to increase real and perceived notions of fairness, for example through pre-calibration meetings on what "good" looks like.*
  - *Be clear in the rationale behind bonus decisions, including the impact of company performance.*
  - *Monitor pay decisions to check that biases aren't leading to unusual outcomes.*

Case Study: Flexibility and self-discovery at Motorola

Motorola ditched its annual 4-point rating scale in 2012. Compensation was decoupled from performance at that time. Standard bonuses are now paid as a percentage of an employee's salary, determined solely on company performance with an additional pool of 25% set aside to reward top performers.

Consider what else hinges on performance ratings – be careful not to remove the screw that holds the structure together

Career decisions can be problematic without ratings

Some companies use ratings as a key input talent decisions. Without ratings, these companies will need to determine a new way to identify an employee that is ready for that next step. One approach is to develop a set of criteria that distinguishes a promotion-ready employee.

Be conscious that a less structured approach opens the risk to employees falling under the radar, or for unconscious bias to creep in. Companies will need to ensure that strategies are in place to mitigate the instance of high performing, but less visible employees losing out.

Ensure you have a process to manage bias in your new approach

Reducing bias involves collecting more, not less, information and points of view. An opportunity to collect data on your company's performance management practices is lost when ratings are removed. This poses the risk that biases (e.g. gender, cultural) can become exacerbated under a more fluid approach.

Top Tips

Build robust moderation practices to manage bias risks:

- *Collect a range of views to ensure different voices are heard when making decisions*
- *At meetings, encourage voices that are against the status quo*
- *Watch out for trends in different groups and call out observations about the overall process*

How can PwC help?

To have a deeper discussion about these issues, please contact:

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