

MODERNIZING **PAY FOR PERFORMANCE:** THE ELEMENTS OF A SUCCESSFUL SHIFT





Throughout recent years, leading organizations have changed the way they measure employee performance. Many other companies have followed their lead, and this significant shift shows no sign of slowing down. The reasons so many employers have made the transition are compelling: aside from being dreaded by both employees and their managers, the traditional annual review has been deemed simply ineffective for managing pay-for-performance by most organizations.

Luckily, there are effective alternatives to the annual review, and they can be applied in any organization. Modernizing pay-for-performance demands a detailed diagnosis of your workforce's current status and needs, as well as careful, strategic planning and implementation. Nonetheless, the shift can be streamlined by following a step-by-step process.

In the coming guide, we'll discuss how you can modernize pay-for-performance in your organization and prepare for a successful shift. The following sections will cover:

- ✓ Recent trends in performance management
- ✓ Best practices for diagnosing your pay-for-performance needs
- ✓ Steps for adapting and updating your performance management processes
- ✓ How to execute your new pay-for-performance plan effectively



Trends in Performance Management

The modern business landscape has seen a significant shift in performance management trends within recent years. This is largely due to the fact that there are a number of common complaints associated with the annual review. For example:

- ✓ **It's too time-consuming.** At Deloitte, the process of creating ratings was reportedly taking the company 2 million hours per year to complete. While that span is likely shorter in smaller organizations, the sentiment of annual reviews taking too much time is widely shared.
- ✓ **The cycle is too long.** Addressing employee performance that happened months ago is argued as being ineffective – instead, managers should discuss performance with employees on an ongoing basis.
- ✓ **It's demotivating.** Especially for anyone who isn't a high performer, annual reviews can have a negative impact on employee morale. In some cases, reviews may even be the reason an employee quits.
- ✓ **It's too focused on the past.** Today, business leaders and employees want to focus on the future, not what happened in the past. Annual reviews are simply no longer relevant to the fast-paced nature of today's organizations.
- ✓ **It isn't always based on actual performance.** Some employees feel that with annual reviews, managers base ratings on the pay they want to give versus actual performance.

Given these criticisms, it's no surprise that the annual performance review is experiencing a downward trend. While the overwhelming majority (96%) of companies used this method to manage performance in 2012, that figure has dropped consistently each year, with 25% of companies using alternate approaches in 2017.



What Are Companies Doing Instead?

Of the companies using an alternative to annual reviews, the majority have implemented half-year reviews. Some are using reviews quarterly or more often, which can be particularly beneficial for rapidly-changing industries. It is likely that more organizations will continue to implement quarterly or monthly reviews or check-ins moving forward.

Also, while just over half of companies (53%) hold conversations about rewards at the same time as performance reviews, 47% time them separately. While this approach may currently be slightly less popular, it does have a unique benefit: holding performance-related conversations roughly two weeks prior to discussing pay gives employees the opportunity to process the feedback their managers have provided.

Why Does the Annual Review Still Exist?

With the ongoing complaints about the flaws in the annual review process, it begs the question: Why not just get rid of it entirely?

While it might seem simple to abandon the annual review, it produces documentation which is a business necessity for making important decisions. It acts as a mechanism for giving feedback, determining promotion eligibility, and identifying the need for termination. Moreover, it answers the questions all employees want to know: What's expected of me, and how am I fulfilling those expectations?

While business leaders have an obligation to answer those questions, there is room for improvement in performance management. Transitioning performance management processes to better fit your company involves three steps: diagnose, adapt, and execute.

Diagnosing Your Performance Review Needs

To diagnose your company's performance review needs, start by establishing a cross-functional team. From there, you can reaffirm your rewards philosophy and determine your pay-for-performance guiding principles. Specifically, what is the purpose of the performance management plan, and what principles will keep you on track during the design and administration of the plan?

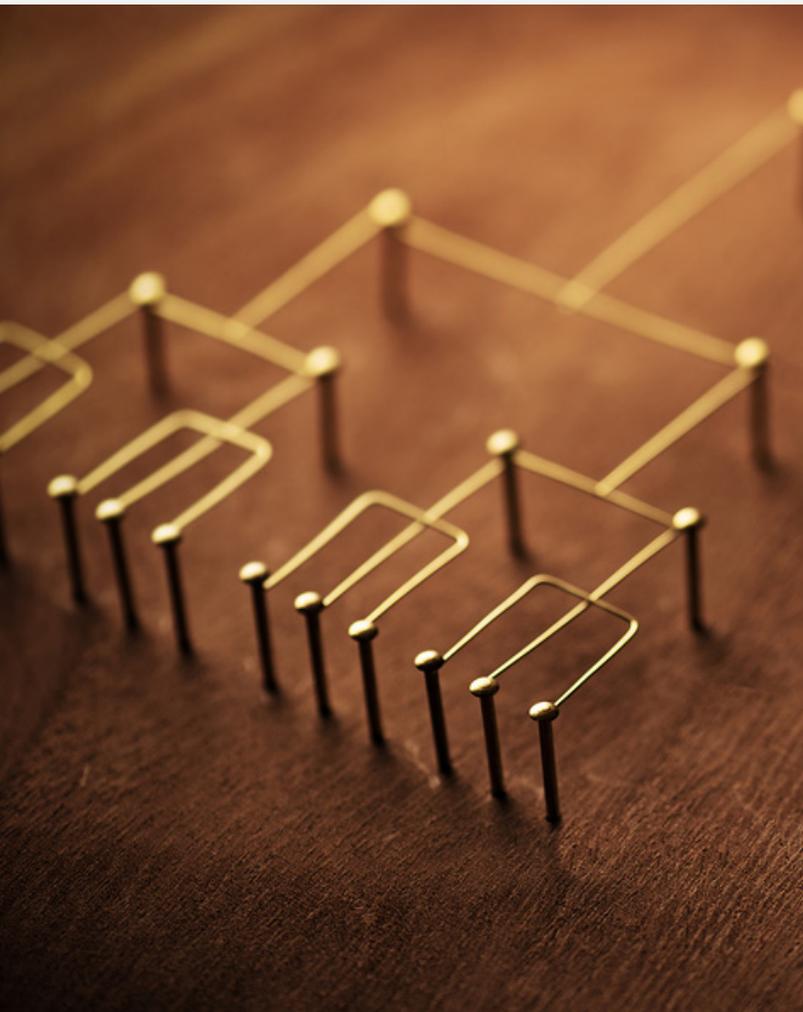
Next, diagnose the internal and external influences that have an impact on your business. This includes the following key steps:



Understanding the Workforce's Current Status & Needs

To develop a thorough evaluation of how your company attracts, retains, and rewards talent, interview key stakeholders and/or top performers. Follow the "12 Pillars Analysis," asking participants to rank the company's view of your company's ability to:

- ✓ Motivate: This encompasses your company's vision, leadership, direction, and teamwork.
- ✓ Engage: The four pillars in this category are empowerment, impact, personal value, and fulfillment.
- ✓ Reward: This area comprises your company culture, development, recognition, and compensation/benefits.





Understanding the Competitive Environment by Location

Each location has its own unique characteristics, and there are thus different types of talent required to be successful in every environment. To understand the competitive environment, determine which talents are required to perform well in each market. Consider the knowledge, skills, and behaviors required, as well as the level of talent each unique location demands.

Understanding the Talent Infrastructure

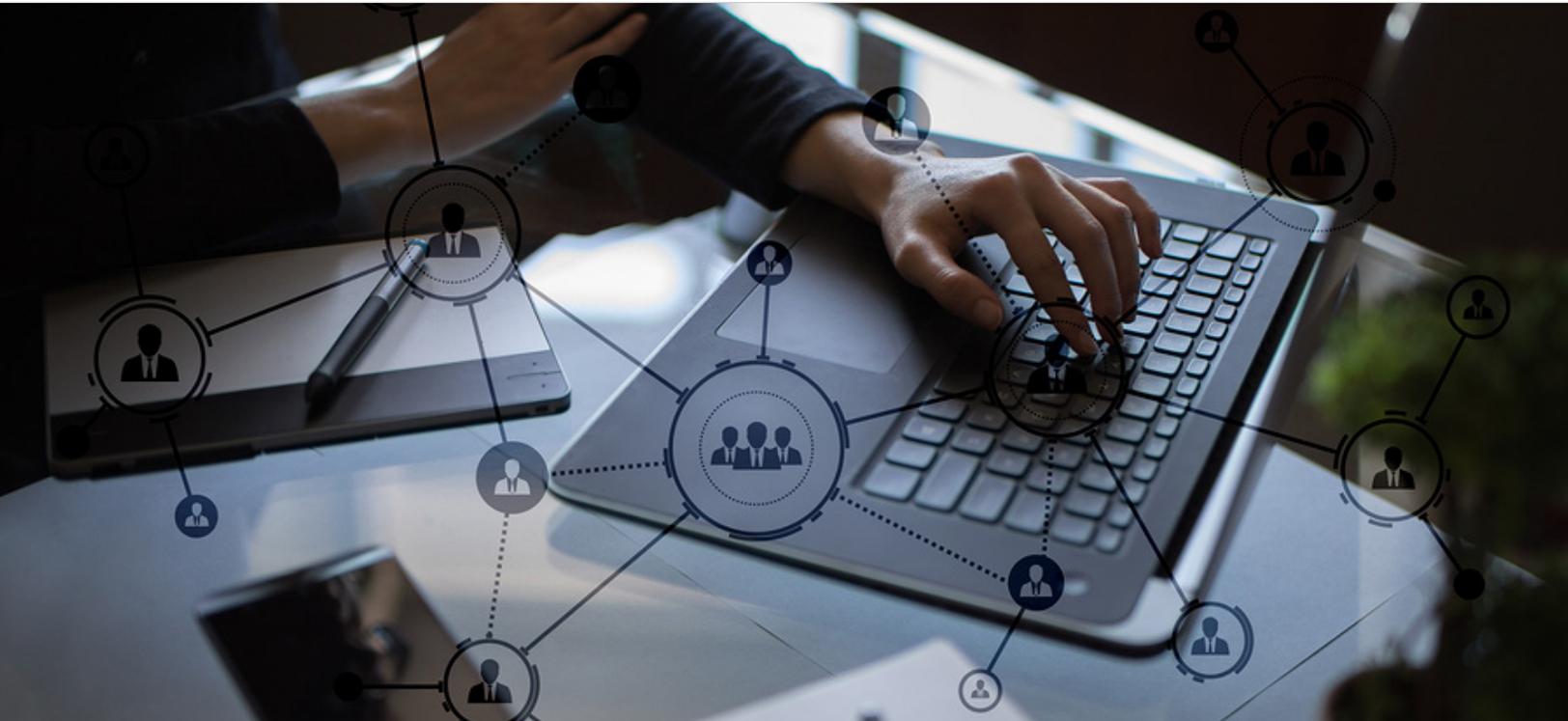
Next, ask yourself whether jobs and levels are defined correctly across the company. Complete a job analysis to understand the key duties of each role, the core competencies needed to be successful, the level of knowledge, skills, and behaviors required, and how the role can achieve objectives in order to meet company goals. Using a tool such as TMA's Competency Library can be helpful in identifying competencies needed for each role.

Employers can enhance performance development and mobility by creating career architecture. Your workforce should be able to understand which jobs are available and what it takes to move. Using a job evaluation engine such as Gradar can be helpful in developing a career matrix, which allows employees to understand potential career paths, including lateral moves.

Talent Profiles

Talent profiles help HR and managers make decisions on how individuals can be coached to deliver their best possible performance, which supports strategic development of the workforce. You can devise talent profiles for your workforce by gathering and recording information on their work style and preferences, accomplishments, performance, and development needs and goals. It is also recommended that you implement a subjective means of measuring competency, such as assessments which can be reaffirmed through 360-degree feedback.

Completing the above steps allows you to set up an infrastructure that enables your employees for success. Matching the right people to the right positions empowers them to perform well, thereby facilitating the accomplishment of both personal and company goals.



Assessing Your HR Systems

Next, take inventory of your current HR systems and their capabilities. Most organizations have systems for core HR (HRIS), recruiting, learning, performance, coaching/selection, and compensation. All systems should be working together, and to ensure you're maximizing your use of them, be sure to familiarize yourself with their unique features.

Policies & Procedures

Are your organization's goals aligned and communicated effectively throughout the organization? In other words, can daily tasks be traced up to the overarching mission and vision of the company? While tasks can change daily and your mission may stay the same for ten years or longer, there should still be coherence among tasks, employee goals, strategic objectives, and the company mission.

Additionally, consider how goals are set. Are they too hard, too easy, or just right? Behavioral science research suggests that goals with a 70% probability of being accomplished are ideal, as they are difficult enough to be engaging yet not too hard to be completely out of reach.

The final steps of the diagnosis phase include creating a compelling value proposition and gaining approval and executive sponsorship. Thereafter, you can move on to the adaptation phase, in which you'll draft a plan, test the design, and assign resources.



Adapting Your Performance Management Processes to Meet Your Goals

To adapt your approach to performance management, start by defining your plan participants and objectives. What areas would benefit from an updated performance development plan? Keep in mind that not all participants have to be on the same plan. Options include performance development, merit pay, short-term incentive plans, and long-term incentive plans.

Identify Benchmarks & Metrics

One drawback of short-term performance incentive plans is that it can lead to consistent pay increases even when significant improvements in performance aren't being made. This can be prevented by switching from annual merit programs to pay adjustments based on competency attainment. This strategy focuses base pay on factors that influence long-term performance and employee development, versus short-term, past performance. However, it will require you to identify competencies by job, as well as a consistent process for measuring them.

One simple way to measure competencies is to list the skills, talents, or behaviors needed for a certain role, then rank employees on a 1-5 scale. The total score would then be divided by the number of competencies listed. Employees should be targeted at the midpoint of the range. If a raise is requested but the employee falls short in a key competency, their manager might offer training or participation in a workshop for that particular skill.

For performance development and short-term incentive plans, you might also consider implementing the 4x4 method. The purpose of this approach is to pay for the attainment of goals and behavior aligned with the company's values. Each quarter, the employee and manager would take turns answering four questions:

- ✓ How did I do in meeting my goals?
- ✓ How did I demonstrate company values?
- ✓ What are my upcoming goals?
- ✓ Which coaching and development resources do I need?

A formal annual rating is then produced at the end of the year.

Lastly, long-term incentive plans can be used to pay for the recognition of a high-potential employee that has a long-term impact on company performance. Consider using a nine-box assessment in which no award, target awards, or above-target rewards are given based on leadership potential and impact on long-term performance.



Execute Your Pay-for-Performance Plan

Once you have designed and adapted your performance management plan, the final step is to execute it. This entails implementation, communication, motivation, and management and follows a four-step process.

Step 1: Build an Administrative Infrastructure

Start by building an administrative infrastructure, and make sure you have the right number of trained administrators to successfully run your program. Then, integrate or enhance your existing system, establish process flows and policies, and determine reporting procedures.

Step 2: Train Managers, Employees, & Support Team

The next step for a successful execution is to train all managers, employees, and support teams. After training senior leaders, cascade training to lower level management and provide support from HR to ensure messages are delivered consistently.

Step 3: Rollout Initial Messaging & Schedule Ongoing Communication Plan

Your initial messaging should be coordinated through multiple channels. For ongoing communication, establish an annual budget, create a communication calendar, and integrate training and communication to new employee onboarding.

Step 4: Obtain Initial Feedback

Finally, seek manager and employee feedback to determine whether additional efforts are needed.

Summary

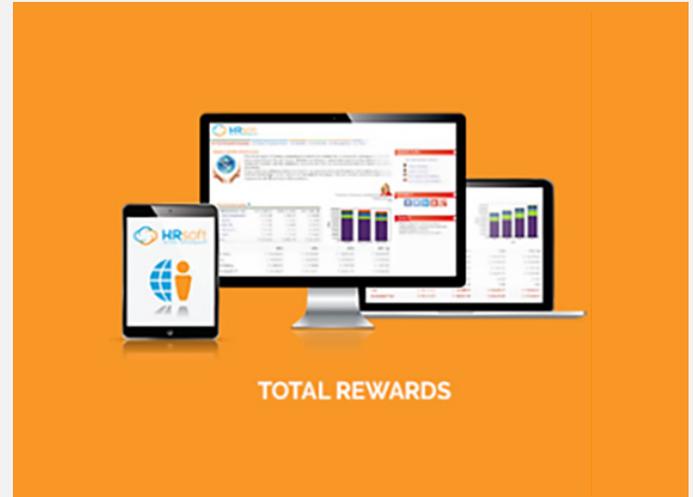
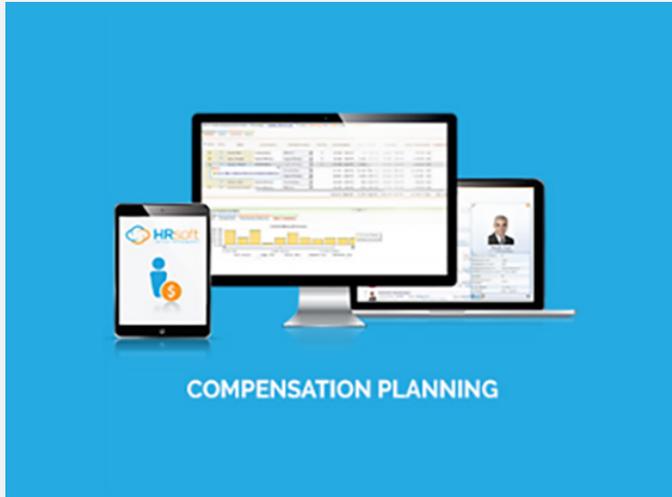
The process of modernizing pay-for-performance is clearly not as simple as applying a "quick fix." Yet, it does have the potential to make a significant impact on your workforce's motivation, as well as the ways in which your managers develop your talent. Moreover, the potential time and cost savings of using an agile pay-for-performance system instead of annual reviews make this approach an attractive solution for many employers.



To review some of the learnings discussed in this guide, here are some key takeaways:

- ✓ The shift away from annual reviews is continuing to gain traction, with a quarter of organizations having already transitioned to more modern practices. Companies are using reviews every six months or at more frequent intervals to address the inherent issues with annual reviews: they are time-consuming, often demotivating, and too focused on the past.
- ✓ Diagnosing your performance management needs is a detailed process which requires careful consideration. You must understand the workforce's current status and needs, the competitive environment by location, and talent infrastructure. Developing talent profiles can help you navigate this process successfully. You should also perform an assessment of your HR systems, as well as your policies and procedures.
- ✓ You can adapt your performance management processes to meet your goals by identifying benchmarks and metrics for the different roles in your company. Then, define the plan mechanics and administration, and model the plan and transition phase.
- ✓ Finally, execute your plan by building an administrative infrastructure and ensuring every party involved has ample training. Rollout your initial messaging, and ensure you're following up with communications on a routine basis. Gather feedback to determine whether you need to refine your approach in any areas.

While the path to success isn't the same for all companies, the framework laid out here can be fine-tuned to meet the needs and unique qualities of each organization. By following these practical tips, you can make a successful shift towards a modern pay-for-performance plan in which your workforce is rewarded fairly and equitably for their contributions, and feedback is shared continuously to support growth and development.



Resources

HRsoft is the trusted global leader in compensation management software whose COMPview solution is proven to control and simplify the full process and allocation of merit, bonus and equity awards to drive manager and employee engagement.

Phone: [866.953.8800](tel:866.953.8800) | Email: info@hrsoft.com | Web: hrsoft.com



About the Contributor

Sam Reeve | President, CompTeam



Sam Reeve is the President of CompTeam, a management consulting firm that focuses on improving the relationship between employee motivation, happiness, and performance. He is a recognized thought leader in human capital talent strategies with over 15 years of experience in leading companies through transformational change by optimizing talent initiatives with reward programs to achieve long-term strategic objectives. Sam's diverse experience includes the design and optimization of performance-driven variable compensation plans for executive, sales, and core employee populations of growing companies.

Phone: [925-596-0147](tel:925-596-0147) | Email: sam@compteam.net | Web: [linkedin.com/company/compteam](https://www.linkedin.com/company/compteam)