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FOUR REASONS TO CHANGE HOW YOU APPROACH PERFORMANCE RATINGS

The decision whether to include performance ratings in your company can be a very polarizing choice. Some people absolutely hate the concept of rating someone's performance, while others think they are an invaluable part of any performance management process. We can see this trend play out as more and more companies start removing ratings from their processes. A 2020 study by the Corporate Executive Board (the CEB) found that 7% of mid-sized companies have removed performance ratings, while another 42% were considering removing them in the near future.

And who could blame these companies for thinking that performance rankings are more hassle than they're worth? Performance ratings cause so much frustration that they often distract from the core foundation of performance management: frequent and high-quality conversations between managers and employees. Over my career, I've known too many managers that hate the idea of performance ratings so much, that they basically check out of all performance management activities.

On the flip side, research shows that removing performance ratings does not always lead to the desired outcomes. All of the sudden, companies struggle to manage the daily performance of their people, and they ultimately struggle to differentiate the rewards across high and low performers. Pay raises, bonuses, and promotions are made based on purely subjective criteria, as opposed to concrete targets. In the end, companies that have removed performance ratings often consider re-establishing them.

The sad truth is that performance ratings are often the scapegoat of a faulty performance management process. We make it hard for ourselves by implementing the next generation of performance tools or super-detailed processes, but the truth is we don't need all of that. We just need to go back to the basics when it comes to goal setting, discussing someone's performance, assessing performance, and rewarding performance.

That is why we started a 4-part series on Performance Management Fundamentals, and how your bank can unlock the performance of your people. In previous months' articles, we discussed why banks should empower their people to determine their own goals and use frequent 1 on 1 meetings to coach the performance of their people. But, obviously, goal setting and performance conversations are not enough, and that is why this month's article will focus on how to translate the person's performance into a performance rating.

PROBLEMS WITH RATING SCALES

The first thing to understand when thinking about performance ratings is why they tend to fail. When designed poorly, a performance rating system can easily drive the wrong behaviors at your bank or incentivize people to inflate their ratings by "gaming" the system. By addressing some core problems with performance ratings, your bank can drive and reward the behaviors you need to grow and succeed.

Problem 1 - Combining things that shouldn't be combined.

Most performance rating systems try to boil performance down to one number or one rating. But by trying to combine all the aspects of performance into one rating, we end up combining things that really shouldn't be combined. For example, 'What you accomplish' and 'How you accomplish it' are two dramatically different things. We all know those colleagues from our past that could deliver great numbers but would leave a trail of dead bodies behind them. By combining the WHAT and the HOW into one rating, we lose the ability to differentiate the people who did their job in the desired way from those who just met their targets.

Problem 2 - Sacrificing the long-term goals for short term achievements.

At its core, performance rating systems are about assessing the performance of what occurred in the recent past (i.e. the past 6 months to a year). While that makes sense, only looking to the past can lead to some problems with the future. For example, I've seen salespeople that spent little time growing newer customers, instead focused on "milking" their existing clients. After 1-2 years of good bonuses, they left right before their accounts ran dry. I've also seen plenty of people who have gotten left behind as their industries evolved and companies grew. These people didn't want to invest in their own development because it might reduce their productivity in the short term, and, as a result, they were unprepared for the future.

Problem 3 - The middle rating bias.

Most rating systems use an odd numbered scale for their ratings (3, 5, or 7). This approach has the benefit of having a midpoint for performance, which is comforting to most managers, as it is a "safe" place to put your average performers. The downside to an odd-numbered scale is that managers tend to overuse the middle rating. Often, this can be attributed to their desire to avoid looking like the "bad guy." Managers are very hesitant to give people a below average rating, and so they end up hiding underperformers in the "safe" midpoint rating.

Problem 4 - Too many stars.

In the theoretical world, performance follows a standardized curve. There should be a few people that are at the top of the performance curve, few at the bottom, and the rest spread across the other ratings. Unfortunately, reality tends to lead to a messier distribution of the performance ratings. But instead of accepting reality, most companies use a forced distribution curve to limit the number of people that can be given the "top" ratings. They argue that resources are limited, not everyone can be the best, and some people must be underperforming. And while that is often true, limiting the number of top performers or forcing below average ratings angers people. They feel it is unfair, especially if their rating doesn't match their self-perceived accomplishments.

FOUR SOLUTIONS TO FIX YOUR PERFORMANCE PROCESSES

Solution 1 - Split the WHAT and the HOW.

I absolutely hate performance systems that combine the WHAT and the HOW of a person's performance. Especially because it gives a false image of simplicity. It is true that having one rating for a person is simpler to understand, but all of the nuances and details that comprise a person's performance are lost. And when we lose those nuances, we lose the ability to make quality talent decisions.

That is why I have always pushed my companies to rate people across multiple factors. At a minimum, all employees should be rated on two performance factors:

1. Impact (the WHAT) - To what extent did the person achieve the objectives that they were assigned to them? Did they deliver the objectives on time and to the expected levels of quality? Ideally, the objectives have some measurable aspect to them. These could include financials, deadlines, quality standards, or other business metrics.

2. Culture (the HOW) - To what extent did the person achieve their objectives in a way that is aligned to your culture? Did they role model the desirable behaviors and make a positive contribution to strengthening the culture? While it is true that the Culture factor is tougher to measure objectively, the manager should gather examples and feedback on how the person worked.

Solution 2 - Add growth to performance ratings.

Splitting the WHAT from the HOW in your performance ratings is a great start, but that solution does little to address sacrificing the long-term for the short-term results. As we identified previously, too many leaders focus on their near team goals, and they fail to prepare themselves and their teams for the future. Even the top performers of today can become tomorrow's failures if they don't proactively prepare themselves, their teams, and their processes for the future.

That is why we recommend adding a third performance factor: Growth. While the WHAT and the HOW are meant to assess what you have done in the recent past, Growth is designed to be focused on the future and what you are doing to prepare for it.

3. Growth (the FUTURE) - To what extent are you preparing your role and your team for the challenges to be faced tomorrow? What have you done to build your skills and capabilities that will help you succeed next year? How have you helped your colleagues or direct reports be ready for future challenges? How have you prepared your team's processes or ways of working to be ready for the future?

Solution 3 - Use a 4-point rating scale.

Helping managers stop overusing the middle rating in a performance system is incredibly tough. A middle rating will always feel like a "safe" option, but it is often just hiding underperformers. Many of companies I know tend to tackle this problem by training managers to be more courageous in giving underperformance ratings. But helping managers get more comfortable having tough conversations is tough. So, instead of telling them to reduce the amount of middle ratings, we suggest removing it entirely.

There is a good deal of research that shows that moving from an Odd number rating scale to an Even number rating scale dramatically improves the quality of the ratings. Our preferred method is the 4-point scale. It is simple, direct, and allows you to differentiate your top performers. So, when combined with the previous 2 solutions, our recommendation is to rate all of your people on 3 separate factors (Impact, Culture, & Growth) using the following 4 performance ratings:

1. Sets a new standard of performance
2. Often exceeds expectations
3. Consistently meets expectations
4. Needs Development

Solution 4 - Stop using forced distributions and instead conduct calibrations.

Finally, we need to address the turd in most performance management processes: forced distributions. I actually really like the concept behind forced distributions. Not everyone can be a top performer, and not everyone adds the same amount of value to a company. Unfortunately, forced distribution is a sledgehammer solution. Even if one team has truly outperformed all other teams, everyone would have to follow the same distribution performance curve.

Instead of forcing everyone into the same pattern, we should recognize that different performance patterns can exist. That is why we recommend using performance calibration meetings amongst managers and leadership teams. The goal is to bring the leaders together so that they can compare and calibrate the performance across their teams. One person might look like a superstar because they are surrounded by an incompetent team but look like an average performer on any other team. These calibration meetings will help your leaders align on your bank's definition of great performance.

<u>FINDING THE WOLF IN SHEEP'S CLOTHING OR THE DIAMOND IN THE MUD</u>

The ability to deliver their strategic vision is what separates Premier Performing banks from the rest of the pack. Think about it … all your competitors probably have very similar financial goals as you. They want to increase their assets, increase their equity, increase their earnings, and decrease their risk. What separates you from your competitors is your people. If you have more top performers then they, then it is more likely you will win.

And that is where a great performance rating system can help. A system like I explained above can help you identify the people that can supercharge or hinder your ability to deliver your strategy. Additionally, it will help you identify the wolf dressed in sheep's clothing or find the diamond buried in the mud. And it is failing to identify those types of people that hinders most companies. We all know the leaders that look great on paper, but then drive their organizations off a cliff. As a senior leader in your bank, you need to make sure your performance process is identifying the best of the best.

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