Personal Performance Commitments:

Setting Individual Objectives for Continuous Improvement

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Observations About Traditional Performance Appraisal

Nearly every company we know is dissatisfied with its performance appraisal program. Repeated efforts to re-design these programs have been disappointing. The assumptions about appraisal are fundamentally flawed. In most companies, performance appraisals suffer from these basic problems:

- they are annual rituals rather than continuous, helpful tools
- at best they focus on short-term results
- they often lack substance; activities are confused with outcomes
- developmental coaching is an after-thought
- objectives are poorly set, usually in top down, mechanical fashion and they are not used as real work plans or control mechanisms
- therefore, they contribute little to greater self-management
- they are overly rigid and don't reflect the dynamic nature of the environment
- rarely do individual's objectives clearly tie to the direction of the business or to others with whom they must jointly work to satisfy customers

Linkage between individual performance plans needs to improve both horizontally – across functions, departments, etc. – and vertically among the levels of organization. Sharing a single vision means allowing all contributors to directly relate their contribution to a single set of organizational outcomes.

The linkage between the business plan and individual performance management is an obvious need; many talk about it, but few do it. The traditional performance appraisal is tied to the compensation administration cycle. Enthusiasm for pay-or-performance, still mostly an elusive concept in a majority of companies, causes management to make performance appraisal the role of the human resources department or, worse yet, personnel administrators.

It has become apparent to a number of companies that performance management is a great deal more than compensation administration. It is becoming clear that in building competitive organizations, committed to continuous improvement, individual performance management must become a more effective process for guiding and energizing self-management, tied to the vision and strategies of the business.

Continuous Improvement and Performance

The quality movement has contributed a great deal to competitive tactics, but with the exception of Xerox and a handful of other companies, it has not had a great deal of practical impact on individual performance management. Deming has criticized traditionally applied MBO approaches as contrary to sustained process improvement. He and others have made a persuasive case for focusing on process rather than today's business results.

Most business people we work with relate to the idea of process improvement. Capable business process, like capable manufacturing process, creates predictability and repeatability of results. It's clear, but few are ready to make the leap of faith to focus all energies on process, while ignoring the expectations of stakeholders for the shorter term. Balance and sustained focus on both are critical; there is no satisfactory option.

Effective goal setting for improvement will focus on both a) current business results and b) process improvement outcomes (capabilities) that can be measured over time; rather than in the form of new objectives every year, there needs to be an ongoing revision of targets with sustained focus on the same set of indicators.

A New Performance Management Design

Most efforts to "fix" appraisal programs focus on forms and programs rather than changing the way we manage performance – the way we plan, the way we provide direction and the way we control critical outcomes. In many cases, there is nothing inherently wrong with the forms currently being used. (One company we know decided to use blank pieces of paper instead of forms to underscore the point.)

We need a different perspective on performance management entirely, one that is fundamentally designed to:

- link all functions, levels and people to the same set of company-wide performance commitments
- integrate short-term (one year) outcomes to long-term (3 to 5 year) outcomes, with sustained measurement
- balance measures for business results and process improvements
- be part of a "way of managing the business" day-in and day-out, rather than a personnel program
- create energy and commitment among people to perform

The approach must be to create a set of personal performance commitments throughout the organization linked together, and linked to a future business plan, that are used to empower people and that are used to hold them accountable.

A Process Framework

The process for defining linked, personal performance plans must start with a set of company-wide outcomes or critical success factors. These company goals for the business should have a 3 to 5 year perspective, agreed to by at least the top layer or two of managers in the business. And they should have a micro quality to them. (We have written elsewhere on a team process for long-term goal setting for business units and have argued individual performance management should start with these kinds of practices.)

Performance management usually need to be planned and measured in twelve-month increments; but each twelve-month horizon should be a logical extension of the last, rather than a new annual administrative ritual or cycle; and the success factors should not change frequently.

The Translation Process

The challenge is to create a cascade process of goal translation through the company, from a broad set of success factors for the entire business progressively toward a set of micro or personal performance commitments for each person in the company for which they have played a very active role in setting.

The general manager of the unit poses a question to his or her team as a group: What are the critical accomplishments for the next twelve months that will be required to support our top 5 to 10 business goals for the next 3 to 5 years. Individual managers are responsible for identifying the key outcomes of their plan. Each manager prepares a draft of personal outcome areas and exchanges them with his or her peers and the general manager. Both team and one-on-one negotiations occur to set the actual targets (how high the bar is set) and clarify ownership.

Top Down vs. Participative Goals

Goal setting is rarely completely participative and it is never a democratic process in business. Even general managers are handed a set of requirements for the performance of a business, base on the expectations of the owners. Unfortunately, he or she may assume a process of mechanically imposing the same targets on direct reports, who in turn, often divide the target by the number of direct reports (or hand their staff the same percentage improvement target) and we are on our way to lots of frustration and, most importantly, sub-optimal results.

If the business must improve its productivity by 6% per year, linkage does not mean giving everyone a 6% target. While it may seem obvious that different areas of a business or a large factory or sales organization do not all have the same opportunity for improvement, year-after-year good companies still set goals as if the reverse were true. Some parts of the organization can contribute more to the macro goal than others, resources should be focused on those areas differently, and performance commitments should be set accordingly.

After a long discussion on the subject of goal setting, a frustrated director of manufacturing recently explained to me, "my department managers have tried to get the supervisors involved in setting goals, but no one is willing to commit; everyone winds up getting frustrated and the supervisors tell the manager to just give everyone their goals; they do and everyone is happy. They think it's more fair that way."

The greatest contribution will be gained from vigorous negotiations, debating and pushing back and forth between manager and team, and among team members, towards the highest level of company-wide improvement. Managers reserve the right to say to the team or to individuals, "collectively, our goals are not high enough; we must do better. I expect you to come back to me with a more aggressive plan." He or she may add, "tell me what I can do to make it possible for you to raise the bar a little higher; what kind of support will you need?"

The obstacles include compensation administration procedures, which drive out risk-taking and willingness to commit to the real improvements that remain untapped year after year. But part of the problem is the lack of a goal-setting process and the lack of process skills on the part of managers.

A Case Study Example

Let's look at an example of a process for negotiating in one very successful client company that is effective at performance management. The president of a billion-dollar division identifies five "critical success factors," expressed as outcome areas, in the three-year operating business plan. These include product superiority, customer service, economic productivity and business system effectiveness.

Additionally, the top team defines a set of measures or indicators (usually not more than five) that will be applied to the division and to everyone's outcomes lists; they determine how to measure success in a given priority. These include: unit sales, unit sales per person, market share, profit before tax, etc.

He and his direct report then work together to define a set of "performance commitments," or objectives for each of the priority areas for the business as a whole. The economic productivity target starts with a set of return on asset requirements set by the corporation.

The president identifies whom among his direct reports he expects to assume primary and contributing responsibility for each performance commitment. Each of the staff, then develops a set of 8 to 10 outcome areas, and later, performance commitments, with the help of their own staffs that cover those division commitments; the president and his staff debate the merits of draft documents and agree as a team on the commitments for each department. It is not unusual for targets to be negotiated upward during the process to the point that department commitments exceed the division commitment.

All functions, including staff groups, are active contributors to performance commitments.

Next, each department head repeats the process of identifying the "responsible person" for each department commitment. Based on shared agreements, individual performance indicators and objectives are negotiated with direct reports. At this point, they cannot debate the department performance commitments; instead, the discussion focuses on what key business indicators and what objectives are required to support those commitments.

This division team prides itself on the level of alignment they have achieved in its own hierarchy of directional elements:

- Mission
- Guiding Principles
- Division Strategic Priorities (five)
- Division Performance Commitments
- Department Performance Commitments
- Personal Key Business Indicators

Let's take a look at more details of an effective process, similar to the one described in the example.

Key Business Indicators Format

The most effective the individual performance commitment process we have seen is the key business indicators document. An effective KBI individual plan format has three elements:

1. outcome areas
2. indicators
3. objectives

Outcome Areas

Outcome areas are major areas of accountability for a given planning period. The individual holding a position is responsible for achieving certain outcomes. The value of any position should be determined by the outcomes it contributes. These position outcomes are valuable to the extent they contribute directly to the critical performance commitments of the business.

Outcomes are usually stated in terms of brief titles. Qualifying sentences can also be used. They should include both a) annual business results and b) major process improvements.

In every case, there are customers that must be satisfied, either internal or external. Outcomes (and indicators) should be defined in customer terms, wherever possible.

Consider examples of outcomes which would likely be found in different type of positions and which should be linked directly to the 3 to 5 year outcomes of the business plan:

- A Profit Center General Manager
    - Financial Results
    - Customer Service
    - Overall Quality Results

- Operational Results
    - Human Resources Outcomes
    - Product Development

- Manufacturing Manager
    - Production Results (Schedule Attainment)
    - Quality Results
    - Cost Results/Contribution
    - Safety Results
    - Human Resources Results
    - Process Capability

- Regional Sales Manager
    - Account Management
    - Sales Revenue
    - Expenses/Contribution
    - Market Development
    - Market Share
    - Human Resources

Indicators

Indicators are a set of measurements for each outcome area. They allow one to determine what indicates effectiveness for a given outcome area. Indicators are not objectives, per se. They are the measure, not the objective itself. The indicators should relate directly to measures for which the business is held accountable.

For example, "account management" may be an outcome for a regional sales manager, under a division outcome area known as "customer service." Indicators for that outcome – how we will measure it – might include accuracy of billing and account profiles, response time on service calls, completion of relationship plans, etc. based on a set of division improvement plans aimed at applying Malcom Baldrige criteria. In effect, they are categories or measurement criteria, to which specific objectives will be attached for a given period of time. Indicators should be expressed in customer terms, whenever possible.

Balancing Process Improvement and Business Results

The skilled leader will learn to effectively balance the right set of current business results and process priorities and will hold people accountable, accordingly. When histories measures, which are not easily changed, are clearly sub-optimal *senior executives* need to insulate operations from these measures, while operations managers focus on improvement, tracked on the basis of process outcomes milestones.

It doesn't mean simply throwing out the old business results measures; the senior executive may continue to track trends on these, but they need not drive operational people, if they are clearly sub-optimal.

In manufacturing, for example, labor efficiencies and traditional absorption measures are clearly ineffective measures for tracking competitive production capabilities in the 1990's. While we wait for the accountants to catch up with innovation in operations, possible indicators for manufacturing *process improvement measures* might include:

- days of parts inventory
- process segment and total cycle times
- average outgoing quality – parts per million
- scrap levels reduced – dollars and units
- successful installation of specific new product/processes

Process improvements are critical changes, which are <u>not results</u> in and of themselves, but which create the capability to deliver results later. They should be stated in such a fashion that their achievement could be verified. How will we know we have succeeded in improving a given process?

<u>Objectives</u>

Objectives are the specific commitments or targets for each indicator. They include both current business results and process outcomes to be achieved within a given time period. Objectives define the level of performance. Vague objectives make it difficult to have confidence that we are making progress.

Objectives may be either quantifiable <u>or</u> verifiable. For example, completion of a project on budget and on time is verifiable.

An illustration of two sections of a KBI document for a district manager in a service and sales unit are provided in the back of this document. In the examples, outcome areas have been categorized into "corporate categories," reflecting a handful of company-wide outcomes that are to be stressed in all divisions and regions of the company.

<u>Preparing the KBI Document</u>

If a set of objectives is to contribute to self-management, they <u>must</u> be developed and set by each individual. Without a clear set of outcomes, self-management is simply not practical. All management employees should eventually play a role in negotiating a meaningful set of KBI's for their position. Key individual contributors usually benefit from a similar process.

The steps include:

1. Prepare a set of Outcomes
2. Add Indicators for each

3. Set Objectives

<u>Preparation of Outcomes</u>

a) Outcomes should be titles suggesting end points, not activities, tied directly to a handful of company-wide outcomes.
b) Identify outcome areas that need regular attention and focus. Don't over-consolidate and don't make them too detailed.
c) Keep to about ten major outcomes of an operating type.
d) The more important areas where results are expected should be listed first.

<u>Preparation of Indicators</u>

a) Start with the needs of internal and external <u>customers</u>. What indicators will intelligently reflect outcomes of real value to them?
b) Each manager lists indicators he or she has significant influence over.
c) Process improvement areas are examined to determine what trends need to be tracked over time. "Improvements in process capability usually take two or more years to achieve.) Establish indicators that will provide trend feedback on critical improvement on a continuous basis.
d) Create a balance of indicators for both necessary short-term business results and critical process improvements. Make certain all indicators are critical.

<u>Preparation of Objectives</u>

a) Each member of the team reviews current effectiveness compared to the company-wide targets
b) A 3 to 5 set of improvement goals are listed for each outcome area. Twelve-month milestones are defined for each.
c) Each manager exchanges targets and the collective impact on the long-term company goals are assessed. The general manager conducts one-on-one discussions to negotiate higher targets, if necessary.
d) Objectives or targets are re-set, as necessary, to achieve the first twelve-month set of targets in the company goals.
e) The process is repeated at each level, cascading downward.

Linkage between people within separate units is key. The process should flow downward in a cascade process. We recommend department heads exchange draft documents before the are concluded. Material support needs should be negotiated among department heads, with the general manager resolving issues the group cannot conclude itself.

Off-site <u>team building workshops</u> can be facilitated by having individual managers negotiate mutual support roles (similar to Roger Harrison's "role negotiation). The focus is on identifying what each will need from his or her peers to achieve the outcomes defined.

Performance Dialogue Processes

The review process is a critical requirement. The importance of feedback simply cannot be overstated. Managers who report success with the KBI process say that regular reviews are essential. They do not refer to a "once-a-year" episode. There are at least four types of reviews worth using. Two are initiated by the individual as part of a self-management philosophy. Two are initiated by the manager to achieve teamwork results and contribute to development.

1. Review of Own KBI Document
   One should look at one's own KBI document on a monthly basis. It helps to make brief written notes regarding results, directly on the document. It is also helpful to prepare a monthly "to do" list relative to each key outcome. This monthly list provides constructive self-discipline on getting the entire job done.

2. Group Review
   Linkage is best assured by continual dialogue around each manager's document. We encourage a supervisor to have a group review on a quarterly basis. The group would consist of the top manager and those who report directly to them. For the group review, the major responsibility areas are used. Each person shares the status of his or her KBI outcome areas, stressing support needs from peers. Internal customer relationships in the "value chain" are examined. The emphasis is interaction, problem-solving and creativity, not "dog and pony shows."

3. Quarterly Direct Report Review of KBI with Supervisor
   This review is an optional one, but recommended especially to benefit from the supervisor's knowledge, experience and advice. All incumbents should take the initiative in scheduling this review when it is needed; quarterly is a good idea.

4. Annual Review by Supervisor
   We see value in the superior reviewing the KBI results of a given person about once a year. The annual review using the KBI should contribute to real self-development. The manager helps people to review:

   a) When they have been successful *and why*
   b) Where they have not been successful *and why*
   c) What is takes to be ready to take on more responsibility

If this annual review is to be attached to annual merit pay administration, this can be easily done. The KBI's can be documented with most established appraisal forms. We recommend separating the merit pay and final rating as a separate transaction.

The four Reviews “close the loop” on a powerful way of integrating the planning function and the controlling function by means of effective leadership.

Changing Objectives

Fulfilling the two primary purposes (self-management and self-improvement) requires working against a meaningful set of objectives at all times. Rarely are annual objectives unchanged for a year. Conditions change and the document must change as well, as mutually agreed to by the incumbent and his/her manager. Therefore, objectives can and should be reviewed at least quarterly. Obviously, they are not going to be changed unless a change is clearly justified.

Development Feedback

Most business people today agree that effective human resources development includes feedback about “how” one achieves results, in addition to feedback about the outcomes produced. This requires different tools from traditional performance appraisal. We are especially impressed with the processes used with companies who have tied coaching evaluation tools, including subordinate survey feedback and peer appraisals to a set of company-wide guiding principles. Some have tied these assessments to base pay, or even bonus pay for senior managers, with varying success. Federal Express is perhaps the most visible of these companies and they report success with the process.

When linked to personal performance commitments, which is a clearly outcomes-oriented process, these developmental feedback tools are powerful. While these broader developmental processes are beyond the scope of the immediate paper, we offer the following suggestions:

- Developmental coaching is rarely effective when it is connected in any fashion to compensation administration. These should be separate tools and processes.

- Evaluations based on how one accomplishes outcomes should be properly balanced with achievement itself. There is no right formula.

- The culture of a company must support upward and peer feedback processes; these are sensitive issues that can easily become punitive events in the wrong environment.

- The top management of the business should be willing to expose themselves to upward feedback before asking middle managers to do so.

Conclusion

Performance management in the 1990’s must product today’s results while improving processes to deliver tomorrow’s results. Self-management requires more effective performance planning tied directly to a few key company outcomes. New practices are needed for managing individual performance.

The process described in this paper is a general management approach that has proven effective for a number of companies. Managers should be trained in the process and the organization should adapt practices to reflect the use of the tools.