TIME TO TAKE A STAND ON PERFORMANCE MANAGEMENT
In today’s business and economic environment, establishing an effective performance management approach is a major challenge for most organizations. This issue is compounded by talent scarcity (externally and internally) for capabilities that organizations need. These challenges, along with recent headlines of global household names making key design changes to performance management, have elevated the question of “what do we do with performance management?” to the C-suite. So what are organizations to do? Examining multiple Mercer studies, client engagements and global trends leads us to four principles that are necessary to maximize the impact of performance management.

1. **FOCUS DIALOGUE: ESTABLISH THE RIGHT GOALS FIRST, THEN TALK ABOUT DEVELOPMENT**

For more than a decade, Mercer’s performance management research consistently has found that the number one driver of performance management effectiveness is manager skill. Our most recent global performance management study reveals HR leaders perceive that having candid dialogue has the biggest impact on the overall success of performance management. With this finding, it is not surprising that recent headlines on talent practices have emphasized design changes that favor more frequent discussions between managers and employees.

Though the importance of candid dialogue is often highlighted in best-practice research, Mercer’s statistical analyses provide further insights. Manager capability in two areas — setting goals and creating development plans — is actually even more important than having candid dialogue. In practice, a company’s performance culture should dictate the level of effort and time spent on goals, development, or both. In weaker or developing performance cultures, effort should be placed first on establishing meaningful goals before focusing on development. If goals are not set on the right things, then development planning will take employees in the wrong direction. Job- and team-specific goals set the foundation for how employees contribute to business objectives, as well as for how employees can be deployed in the organization. In high-performing organizations, where there is an instinctive knowledge of what good performance looks like and goals are well defined, dialogue is of the most value when it focuses on the future and how the employee fits into that vision.

Mercer’s 2016 Global Talent Trends Study\(^1\) reveals employees are eager for discussions that focus on their development. Only one in four employees believes that their organization is doing enough to keep their skills relevant, and managers are pivotal to changing this picture. Compounding the urgency to address this matter is that three in 10 employees are planning to leave their organization, despite being satisfied in their current role. Lack of development and career progression are the main reasons given.

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Performance management has historically been viewed as the single HR process that adds the least amount of value but takes the most amount of time. Across a wide array of companies, managers and employees alike use words like “cumbersome,” “time-consuming,” and “a waste of time” to describe traditional performance management practices.

While headlines call out that companies are abolishing performance management, the truth is that they are shifting the design and processes they have in place to better align with what they want to accomplish through performance management. Regardless of whether a company has eliminated or retained performance ratings, a fundamental shift is occurring in the way that companies approach time allocated to performance management activities. A key question that should guide decisions on time allocation is, “What will inspire and engage employees to commit to our business goals?”

Mercer’s 2016 Global Talent Trends Study showed 82% of companies have an increased focus on building talent versus buying talent, requiring organizations to retain key talent at a greater rate than they have in the past. The increased emphasis on building from within is a huge dilemma during a time when headlines indicate that millennial workers job hop, on average, every two years. In the same study, more than a quarter of employees, mostly millennials, indicated that they do not see a long-term career in their current organization or see better opportunities elsewhere. The opportunity for organizations lies in engaging employees, including painting a compelling picture of long-term career paths and how employees fit into the broader organization. Managers are in the driver’s seat in making sure that employees hear messages about their individual potential and how that aligns with future opportunities within the organization.
It is surprising to find that, despite the global rise in technology dependence and availability of data, few organizations maximize the use of internal data to evaluate the outcomes and overall effectiveness of talent programs. According to Mercer’s 2016 research, few companies are leveraging the talent data they have available to run descriptive analytics (e.g., do stronger performers receive higher pay) and only 10% of companies are conducting predictive analytics. Lack of measurement is a huge roadblock to understanding whether HR programs are having the desired impact. As a result, making the case to the C-suite about the value to the business is difficult and can result in HR programs not being adequately supported or funded.

Prior Mercer research shows that performance management compliance measures, rather than strategic measures, are more likely to be tracked. For example, three out of four organizations report measuring the percentage of the workforce completing performance evaluations. Yet only 23% of organizations measure the percentage of high performers selected for succession or high-potential programs, and just 19% measure the differentiation in retention rates between top and poor performers. While nine in 10 organizations have a pay-for-performance philosophy, surprisingly only four in 10 actually measure the alignment between performance ratings and compensation decisions. A focus on measuring the desired outcomes of the performance management program will help to demonstrate the value of the program on critical business results.

Even companies that have recently made headlines for their progressive design changes question how to accurately measure the effectiveness of manager–employee discussions. Though these discussions constitute a vital piece in creating a feedback-rich work environment, this approach is most effective when coupled with a method of evaluation that has some level of standardization. One approach is to review team engagement scores. Another approach is to use upward feedback to measure people managers’ effectiveness in setting goals, coaching, and providing career guidance.

Effective upward feedback and measurement generally requires an organizational culture that is comfortable with transparency and openness. Organizations that are less comfortable with feedback, or that have a history of penalizing mistakes made during innovation and change, will face additional challenges in creating a feedback-rich environment. Those who are honest about their company’s readiness will be more likely to succeed in creating measurement approaches that will fit their culture and can be ramped up over time (e.g., starting upward feedback with select leaders and then rolling out to a broader group).
Eliminating Ratings? Think Twice About It.

Mercer’s recent Global Talent Trends Study surveyed over 4,500 employees in 15 countries on key workplace issues and priorities. One of the key findings was that employees value performance ratings. Why? Two reasons:
1. Employees use their assigned rating to better understand where they stand.
2. Employees believe a rating is an effective way to drive pay decisions.

With this said, Mercer firmly believes an organization can successfully communicate to employees where they stand and link performance to pay — with or without ratings. In a no-rating environment, an organization can promote fruitful discussions about goals, performance, and development. These organizations can also make performance-based pay decisions, relying on manager discretion, calibration committees, various business metrics, or a combination of methods to deliver base salary and/or incentive pay.

Many organizations are in the process of considering whether ratings, as a design element, enhance or hinder their performance management approach. Below are three rating approaches chosen by organizations as the best fit for their respective environments, showing that “one-size-fits-all” is not the best approach.

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<th>Rating Approaches</th>
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<td><strong>Delinking pay and performance</strong></td>
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<td>Globally, nine in 10 organizations have a pay-for-performance approach, in part to drive employees to higher levels of performance to positively impact business results. A Fortune 100 multinational is exploring whether to completely abandon annual merit increases. As part of their re-design, they are questioning whether 3% differentiation really has impact at the individual level.</td>
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<td><strong>Pay for performance with no ratings</strong></td>
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<td>While there is concern about the potential legal exposure of continuing to link performance to pay decisions, some firms have found a way to make the process more legally defensible. One firm who has eliminated performance ratings uses a series of job-specific financial measures as inputs to the pay allocation discussion. They have found that this method has led to more sound pay-for-performance decisions over the past few years.</td>
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<td><strong>Maintaining ratings</strong></td>
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<td>With all the press about elimination of ratings, some companies have explored this design change but have decided to maintain overall performance ratings. A global professional services firm conducted an internal labor market analysis that revealed consultants value the overall rating they receive and that ratings are one of the most critical factors in retaining top talent.</td>
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Mercer’s *Inside Employees’ Minds* research² has consistently revealed that for over the past decade the most valued element of the employee value proposition is base pay — surpassing retirement savings, low healthcare costs, bonus opportunities, and paid time off. Prior Mercer research also shows that only one in 10 organizations provides a separate rating on people management, which in turn greatly impacts compensation decisions. Since strong people management is a critical differentiator for effective performance management and nine in 10 organizations have a pay-for-performance philosophy, it is advantageous for organizations to explore what they can do to directly link people management to compensation in a meaningful way.

Although rewards philosophies vary from company to company, base salary is often established in relation to the cost of labor (i.e., how much it costs to attract and retain talent), while incentives tend to be funded and allocated based on short- or long-term performance. Once leaders become effective at inspiring and motivating their teams, this is a skillset that typically maintains or improves over time. Thus, it might be more logical to reward this skill as part of base salary rather than as an incentive — changing the messaging around the importance of people management.

Even with a small budget for pay adjustments or merit increases, strong people managers can be protected and rewarded to support the development of their organizations’ future leaders. Organizations will need to be creative, potentially positioning above-market base pay for sustained strong people management, while positioning pay for less critical skills lower in the pay range. This can help an organization be prudent and targeted with limited compensation budgets. Although this practice is uncommon in the marketplace, organizations can set themselves apart by substantially rewarding strong people management, and integrating this into their employee value proposition.

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THE MANAGER’S ROLE: IT CAN BE LONELY AT THE TOP

As the leader of a team or group of teams, a manager can sometimes find his or her job isolating. At times, HR Business Partner support and manager training can be perceived as being too general to be useful or not coming at the right time. Some best-practice companies have taken on this challenge and have found ways to build manager confidence to have meaningful discussions with their team members.

- One big-box retailer uses peer coaching, where store managers are assigned to a small group of regional peers who meet monthly via conference call. The calls provide a forum for focused discussions on people management, talent planning, and employee concerns, including how to have effective coaching and development discussions with specific direct reports.
- A professional services firm uses talent calibration meetings that occur three times a year as a way to stay centered on talent. During the calibration meetings, leaders discuss and reach consensus on each employee’s performance, potential, development opportunities, and rewards. These qualitative discussions provide insights that can then be used to guide one-on-one discussions with direct reports, including delivering key messages.

At the heart of Mercer’s recommended principles is the role of people managers — how they spend their time and how the company measures and values their capability and impact on the business. Regardless of the performance management design — with or without ratings — focusing on these principles will have the greatest impact on engaging top talent and driving performance outcomes. It is time that organizations recognize the impact of people management and reward this skillset directly. Investing in managers not only improves results today but also builds the bedrock for sustained results for years to come.
ABOUT MERCER

At Mercer, we make a difference in the lives of more than 110 million people every day by advancing their health, wealth, and careers. We’re in the business of creating more secure and rewarding futures for our clients and their employees — whether we’re designing affordable health plans, assuring income for retirement, or aligning workers with workforce needs. Using analysis and insights as catalysts for change, we anticipate and understand the individual impact of business decisions, now and in the future. We see people’s current and future needs through a lens of innovation, and our holistic view, specialized expertise, and deep analytical rigor underpin each and every idea and solution we offer. For more than 70 years, we’ve turned our insights into actions, enabling people around the globe to live, work, and retire well. At Mercer, we say we Make Tomorrow, Today.

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