Chapter 9
Performance Management

Chapter Outline

Evaluating Performance

Performance evaluation programs represent a significant application of motivation theory. The process of evaluating an individual's performance contains elements of both positive and negative reinforcement. How well people perform is largely determined by whether their performance is evaluated and rewarded.

Multi-Dimensionality of Performance

What are the behavioral requirements of effective organizations and how do organizations want their members to behave? Effective organizations require three basic types of behavior:[1]

1 **Attracting and holding people in the system.** The first requirement of every organization is to attract people and persuade them to stay for at least a reasonable period of time. Every organization (other than the military when the draft is in effect) depends on its ability to attract members, and the failure to attract a sufficient number of new members could prevent it from functioning effectively and even cause it to die. High turnover and absenteeism are very costly and as a general rule organizations that are more successful in attracting and holding people are more effective.

2 **Dependable role performance.** Members are assigned to perform their individual roles, and they are expected to know their responsibilities and achieve minimal levels of quantity and

quality performance. In general, organization are more effective if their members are motivated to do their assigned jobs and to do them well.

3 **Spontaneous and innovative behaviors.** In addition to the formal task requirements, numerous other behaviors profoundly influence the effectiveness of an organization. These are called spontaneous and innovative behaviors because they are not stated in the formal task requirements. Since an organization cannot foresee all contingencies within its operations, its effectiveness is influenced by the willingness of its employees to perform spontaneous and innovative behaviors as the need arises. Some of the most important spontaneous and innovative behaviors include these:

— *Cooperation:* coming to the aid of co-workers and assisting them in achieving the organization's goals.

— *Protective acts:* where employees go out of their way to remove hazards or eliminate threats to the organization.

— *Constructive ideas:* contributing constructive and creative ideas to improve the organization.

— *Self-training:* engaging in self-training programs to help the organization fill its ever-present need for better-trained personnel.

— *Favorable attitudes:* where employees strive to develop favorable attitudes about the organization among themselves, the customers, and the public, thus facilitating recruitment, retention, and sales.

Role of Performance Evaluation

Many organizations, especially smaller ones, do not have formal evaluation programs because they have survived without them in the past and they see no benefit from them in the future. Whether a company should formally evaluate employees is an important philosophical question that needs to be carefully considered. Performance evaluation programs serve at least five important organizational functions.

1. *To reward and recognize performance.* Evaluation information allows high performers to be rewarded and recognized. Merit pay programs, for example, base the size of pay increases on performance. Without performance data, everyone has to be rewarded equally or rewards have to be distributed subjectively – conditions that are perceived as inequitable by the recipients. Performance appraisals also provide intrinsic rewards, since outstanding performers receive positive recognition for their efforts.

2. *To guide personnel actions such as hiring, firing, and promoting.* Performance information is necessary for making rational decisions about whom to promote and terminate. When this information is not available, personnel actions are made by subjective impressions. It is more desirable to make careful, defensible decisions based on good performance data. Organizations that fail to have a formal evaluation program are vulnerable to costly legal challenges. Without accurate performance data, organizations cannot show that their personnel decisions are free from illegal discrimination on the basis of race, religion, sex, national origin, or age.

3. *To provide individuals with information for their own personal development.* Individuals need performance feedback to help them improve; accurate and timely feedback facilitates the learning of new behavior. Furthermore, most people want to know how well they are doing and where they need to improve.

4. *To identify training needs for the organization.* A well-designed performance evaluation system helps to identify which individuals or departments could benefit from training, and what abilities and skills are needed for each job.

5. *To integrate human resource planning and coordinate other personnel functions.* The information obtained from a performance evaluation is essential for individual career planning and for organizational staffing. Performance information is used to identify high potential people, who are known as "fast-track" employees.

Criticisms of Performance Evaluation

In spite of its importance, the evaluation process has been severely criticized, and these criticisms have prompted many managers to abandon performance evaluation as a useless and perhaps harmful practice. Many people, especially low performers and people who dislike work, simply dislike being evaluated. These individuals oppose having anyone evaluate their performance and view it as a threat.

The process of evaluating performance can also be threatening to supervisors. Evaluating the performance of subordinates is a basic supervisory responsibility, and a supervisor who lacks the skills to evaluate performance and to provide performance feedback simply cannot be a good supervisor. Nevertheless, some supervisors do not like to evaluate their subordinates, and they feel threatened by having to explain their evaluation. These supervisors argue that having to evaluate subordinates creates role conflict by forcing them to be a judge, coach, and friend at the same time. Many supervisors do not have adequate interpersonal skills to handle evaluation interviews.

On some jobs, especially jobs that do not produce a physical product, performance is difficult to define. Managers provide leadership, engineers create new ideas, and trainers present information, but these products cannot be meaningfully counted. So how do we know what to measure? While some argue that intangible products such as new ideas, leadership, and training cannot be reliably measured, others argue that everyone can be measured even if it is only by a subjective rating scale. These people argue that if an evaluator has an attitude about an employee's performance, this attitude can be evaluated like any other attitude, regardless of how subjective it is. Organizations need to be careful, however, that these subjective judgments are job related. Because subjective evaluations can give rise to discrimination against protected groups, the federal courts have not been willing to accept evaluation procedures that allow "unfettered subjective judgments." In some instances organizations have been required by the courts to establish objective formal guidelines for evaluation, promotion, and transfer.[2]

Evaluating performance and assigning a number to represent it often creates feelings of anxiety in both the evaluator and the person being evaluated. Eight of the most frequent criticisms of performance evaluation are described in Exhibit 9.1. Although these criticisms represent legitimate problems, they should be treated as problems needing to be resolved rather than as insurmountable obstacles.

Performance Evaluation Methods

Performance evaluations occur whether or not a formal evaluation program exists. The demands to hire, fire, promote, and compensate all necessitate some form of evaluation. Supervisors have always evaluated their subordinates and formed impressions about each employee's work, and these informal, subjective evaluations have influenced personnel decisions just as much as formal written evaluations. The advantage of an informal system is that it is easier to design and administer; the advantage of a formal program is that it is more unbiased, defensible, and open to inspection.

Exhibit 9.1 Criticisms of Performance Appraisals

1. Halo Effect: Sometimes one characteristic about a person, positive or negative, strongly influences all other attitudes about that person.
2. Leniency-Strictness Effect: Some evaluators give mostly favorable ratings, while other evaluators evaluate the same performance more unfavorably.
3. Central Tendency Effect: Some evaluators give average ratings to everyone to avoid sticking their necks out to identify marginal or outstanding performance.
4. Interrater Reliability: Two evaluators seeing the same behavior, may disagree and give different ratings.
5. Contrast Effect: The evaluation of one employee's performance may be influenced by the relative performance of the preceding individual.
6. Zero-Sum Problem: Some appraisal systems require supervisors to balance high ratings given to some employees with low ratings given to others.
7. Numbers Fetish: An excessive focus is sometimes placed on numbers which may be treated as though they possess unquestioned accuracy.
8. Recency Effect: Recent events are unduly reflected in the appraisal to the exclusion of events earlier in the year.

The popular proverb – what you evaluate is what you get – emphasizes the importance of evaluating behaviors that are essential to organizational effectiveness. The importance of evaluating relevant behaviors was illustrated by the experience of a military officer who included “orderliness” as one of the criteria for evaluating a unit of clerk-typists.[3] The officers who conducted the evaluation defined orderliness in terms of how clear and uncluttered the clerk-typists kept their desks. The clerk-typists responded by removing everything from the tops of their desks and keeping it in their desk drawers. Although the procedure was inefficient, and the volume of work dramatically declined, the clerk-typists obtained high performance evaluations.

Deciding what to evaluate is in part a value judgment. The personal values of those who design the evaluation system will be reflected in it. In deciding what to evaluate, an important issue is whether the evaluation should focus on outcomes (results) or behaviors (activities). For example, the performance evaluation of a salesclerk could focus on the number of products sold per hour or it could focus on the behaviors required to produce the sale such as describing the product, arranging for financing, and making repeat calls. When asked most people say outcomes are more important to measure than behaviors; they are primarily interested in measuring results. However, most performance evaluations focus more on behaviors than on results, especially when evaluating managers and supervisors.

The major advantage of focusing on outcomes is that attention is directed toward producing specific results. The primary objective of all employees should be to produce results, not behaviors. Unfortunately, some employees perform many of the right behaviors and still fail to produce results. This situation can be illustrated by examining the behaviors of a student writing a research paper. The right behaviors include finding references, reading articles, making notes, and studying the materials. A student can perform all these activities very well and still fail to get the paper written.

A potential problem with exclusively evaluating outcomes is that the results can sometimes be achieved by unethical or undesirable means. By exerting excessive pressure on subordinates, supervisors usually can increase performance. But over time, excessive pressure can lead to turnover, dissatisfaction, and unethical conduct. In managing people, the way it is done (behaviors) is just as important as the results (outcomes).

Good performance evaluation programs depend more on the competence of the evaluator than on the specific evaluation technique. Nevertheless, some appraisal techniques are considerably better than others, depending on the purpose of the evaluation and the nature of the work being done. The primary techniques include ranking procedures, classification procedures, graphic rating scales, behaviorally anchored rating scales, and descriptive essays.

Ranking procedures. The objective of a ranking procedure is to order a group of employees from highest to lowest along some performance dimension, usually overall performance. Ranking is frequently used when making promotion decisions and occasionally used when making compensation decisions to decide which employees should get the largest financial bonuses. However, ranking is not helpful for providing personal feedback.

Classification procedures. Classification procedures simply assign individuals into one of several categories, such as outstanding, excellent, good, fair, and poor. This procedure is typically used to evaluate an individual's overall performance, although individuals can also be classified on specific performance dimensions, such as quantity of work, quality of work, and cooperativeness.

Graphic rating scales. Graphic rating scales are the most frequently used method of evaluating performance for nonmanagerial workers. Some of the most popular characteristics measured by graphic rating scales include quantity of work, quality of work, cooperativeness, job knowledge, dependability, initiative, creativity, and overall performance. The scales used to measure these characteristics are typically seven or ten point scales that are described by such words as high versus low, or exceeds job requirements versus needs improvement, as shown in Exhibit 9.2. The accuracy of graphic rating scales and their freedom from bias and subjectivity improve as the points along the scale are more accurately described in behavioral terms. Ideally, each point along the scale should be defined by a specific behavioral description.

Behaviorally based rating scales. When the points along a graphic rating scale are clearly defined by specific behavioral descriptions, as shown in Exhibit 9.3, these scales are then called behaviorally anchored rating scales (BARS). Research indicates that behaviorally anchored rating scales are superior to regular graphic rating scales because they are more reliable, less ambiguous, and less biased; furthermore, they are more accurate measures of performance and provide better feedback to employees.[4] The disadvantage of using behaviorally based rating scales is that more time and effort are required to develop these scales.

Exhibit 9.2 Illustration of a Graphic Rating Scale

Name of Employee Department Date	Job Title Rated By

Instructions: Rate this employee on the basis of the actual work he or she is now doing. Read the definitions very carefully. Compare this employee with others in the same occupation in this company or elsewhere. In the space before each number, rate the employee according to the following scale.

1	2	3	4	5	6	7	8	9
Fair				Average				Excellent

[]	1.	Quantity of Work: How does the quantity of this employees work compare with what you expect. Is this employee energetic and industrious, or does he or she waste time?
[]	2.	Quality of Work: How does the quality of this employee's work compare with what you expect? Consider the degree of completeness and the number of errors and mistakes.
[]	3.	Dependability and Responsibility: Habits of punctuality and attendance. Can this employee be trusted to complete work with a minimum of supervision?
[]	4.	Initiative, resourcefulness, and leadership: Consider the employee’s ability to proceed without supervision and achieve results without being told. How does this employee affect the output of co-workers? Does he or she have the ability to direct and train others and utilize company resources and properties effectively?
[]	5.	Judgement: Does the employee impress you as a person whose judgement would be dependable even under stress? Is the employee likely to be excitable or hasty when making decisions in an emergency? Are decisions objective and rational, or swayed by feelings and the opinions of others?
[]	6.	Ability, training, skill, and experience: Does the employee have sufficient job knowledge to perform the job satisfactorily? Does the employee need additional training on the job?
[]	7.	Personal appearance and speech: Does the employee make a good first impression? Is the employee well-groomed, or slovenly? Does the employee have a pleasant speaking voice? Does he or she express thoughts and ideas?

Descriptive essays. Some performance evaluation forms simply provide a blank space for the evaluator to write a descriptive essay summarizing the employee's performance. New and inexperienced evaluators find this procedure extremely challenging and unpleasant; however, experienced evaluators use it quite effectively. The essay description typically identifies the employee's job responsibilities on one side of the page and the other side of the page contains a description of how well these duties have been performed. If they want to, evaluators are free to construct and use their own scales to facilitate their essay descriptions. One of the major benefits of a descriptive essay procedure is that it provides valuable feedback to help employees improve their performance. The major disadvantage is that the information cannot be used readily to make comparisons between employees.

Exhibit 9.3 Illustration of a Behaviorally-Anchored Rating Scale

Cooperation and dependability refers to spontaneous and innovative behaviors beyond the formal job description with contribute significantly to the effectiveness of the company, e.g. dependability, willingness to accept assignments, cooperation in working with others, initiative in seeing what needs to be done and doing it willingly.		
Excellent attitude	7	Positive and enthusiastic approach to work. Always pleasant, helpful, and cooperative. A self-starter. Strives to further the company's interests.
Good attitude	6	Excellent and enthusiastic worker, willing to do more than expected. Always pleasant and cooperative unless criticized or mistreated.
Slightly good attitude	5	Performs assigned work but conveys the attitude that they would rather not be asked to do anything special.
Average attitude	4	Adequate worker, but occasionally allows personal problems to influence work much of the day.
Slightly poor attitude	3	Sometimes resistive; may even resist performing tasks that are part of the normal job.
Poor attitude	2	Sometimes resistive; may even resist performing tasks that are part of the normal job. Argumentative and sometimes nasty to co-workers.
Very poor attitude	1	Occasionally acts belligerently and in a hostile manner to supervisors

Results-oriented Appraisals

Many organizations emphasize individual accountability through a results-oriented approach to performance evaluation. Less emphasis is placed on the activities employees perform and more emphasis is placed on the results they are expected to produce. Many labels have been attached to these results-oriented evaluations. The most popular label is management by objectives (MBO).

Peter Drucker is credited with first publicizing MBO in his 1954 book, *The Practice of Management*.[5] Drucker noted the advantages of managing managers by "objectives" rather than by "drives." The advantages are that each manager from the highest level to the lowest level has clear objectives that reflect and support the objectives of the organization. All managers participate in the goal setting process and then exercise self-control over their own performance; that is, they monitor their own performance and take corrective actions as necessary. To do this, their performance is measured and compared with their objectives. The measurements do not need to be rigidly quantitative or exact, but they must be clear and rational.

MBO is primarily a philosophy of management that reflects a positive proactive way of managing rather than a reactive way. The focus is on: (1) predicting and shaping the future of the organization by developing long-range organizational objectives and strategic plans, (2) accomplishing results rather than performing activities, (3) improving both individual competence and organizational effectiveness, and (4) increasing the participation and involvement of employees in the affairs of the organization.

MBO is also a process consisting of a series of integrated management functions: (1) the development of clear, precise organizational objectives, (2) the formulation of coordinated individual objectives designed to achieve the overall organizational objectives, (3) the systematic measurement and review of performance, (4) the use of corrective action as needed to achieve the planned objectives.

MBO programs are typically implemented in three phases. The first phase focuses on evaluating managers by having them identify measurable objectives and recording how well they have achieved them at the end of a period. In phase two, MBO programs are integrated into an organization's planning and control processes so that the objectives are coordinated with the strategy and objectives of the company. Phase three integrates the MBO system with other organizational functions including performance evaluations, budgeting and financial planning, the development of strategic plans and overall goals, staffing, compensation, human resource development, and management training and development. This integration is achieved by emphasizing teamwork and flexibility during the goal setting process, and by emphasizing individual growth and development during the performance review process.

Performance Feedback

The importance of performance feedback is emphasized in learning theory. Operant conditioning explains how feedback is essential for acquiring new responses and why learning cannot occur without timely feedback. Feedback is also central to goal setting theory since the goals are meaningless when feedback is absent. There is no uncertainty about the importance of feedback; but there are questions about the most helpful way to give it.

Some recommendations for giving feedback are inconsistent with empirical research. For example, learning theory recommends that feedback occur immediately after the response for optimal learning. However, supervisors are also cautioned to postpone telling employees what they did wrong until they can do so privately to avoid public humiliation. Another popular recommendation is that supervisors should limit their feedback to positive comments and avoid criticism. Studies on discipline have shown, however, that criticism is useful and even necessary to improve performance.[6] The interesting paradox regarding criticism is that those who need it most are usually the most threatened by it and the least capable of benefitting from it. Research on the effects of performance feedback has produced these conclusions:

1. Supervisors give subordinates feedback more often after instances of good performance than after instances of poor performance. People dislike being criticized and giving negative feedback creates an uncomfortable discussion. Consequently, many supervisors avoid giving negative feedback.[7]

2. When they are compelled to give negative feedback, supervisors tend to distort the feedback to make it less negative or convey the feedback in very specific terms in order to convince the subordinate that the evaluation was not biased.[8] Distorting the feedback is dysfunctional, while giving specific comments is generally beneficial and helps the person know how to improve.

3. Supervisors have traditionally been told that discussions about performance levels and pay increases should be separated. Research evidence does not support this, however. Discussions about pay increases represent a significant form of feedback that clarifies and reinforces other comments about performance. Therefore, performance reviews should include information about the recommended pay increase that accompanies this performance level.[9]

4. Feedback tends to improve performance to the extent it indicates that prior performance levels are inadequate for reaching the goal. Therefore, negative feedback that implicitly calls for greater

effort tends to improve performance more than positive feedback that endorses current performance levels.[10]

5. Individuals who are high in self-efficacy and self-esteem can respond more adaptively to criticism than individuals who are low. People with high self-efficacy and high self-esteem are more likely to use the feedback to diagnose their performance and make adaptive changes while people who are low are more inclined to coast or quit.[11]

Performance interviews are usually uncomfortable experiences for both supervisors and subordinates. But they are also significant events that have an enormous impact on employee motivation, personal development, and job satisfaction. Good performance reviews require good interpersonal skills, accurate performance information, and careful preparation. The feedback is most helpful when supervisors describe behavior in a way that is direct, specific, and nonpunishing.

Evaluation Process

Who Should Evaluate Performance?

In most instances, the immediate superior should be responsible for evaluating an employee's performance, although information can also be obtained from subordinates, peers, clients, and customers. When data comes from all of these sources the appraisal is referred to as a ***360 degree appraisal***. As a general rule, performance appraisals are more accurate and useful when the evaluations come from sources closest to the person being rated.

Supervisors. The hierarchical arrangement of formal authority in most organizations gives the supervisor the legitimate responsibility to evaluate subordinates. Generally there is a shared expectation that the superior has both the right and the obligation to evaluate performance. To behave otherwise would seem unnatural and inappropriate. Furthermore, since supervisors administer the rewards and punishments, they should be responsible for evaluating performance.

Subordinates. Although evaluations of superiors by subordinates might seem backward, they can be useful in some circumstances. Subordinates are being asked more frequently to evaluate corporate officers in what are sometimes called upward appraisals or subordinate appraisals, and this information may be used to decide pay increases and promotions. There are at least three good reasons for using subordinate appraisals: (1) subordinates possess unique information about superiors that ought to be included in the evaluation process, (2) feedback from subordinates provides a powerful impetus for change, and (3) evaluations by subordinates tend to equalize the power differentials in organizations and make the workplace more democratic and responsive to human needs. Power equalization increases the flow of communication.

Subordinate evaluations of superiors have certain limitations. Subordinates can only evaluate what they observe, and they generally evaluate their superiors based on their interactions with them. This means that supervisors are primarily evaluated on the basis of consideration rather than organizational effectiveness. Some administrative decisions are not popular, and a desire to please subordinates could cause managers to make bad decisions. Subordinate evaluations also have the potential of undermining the legitimate authority of superiors and of reducing their organizational effectiveness. For a two-way evaluation process to function effectively, both superiors and subordinates must have adequate maturity to make responsible evaluations and to accept feedback from one another.

Peers. In some situations, the most knowledgeable and capable evaluators are an employee's peers. Coworkers are sometimes in a better position than their supervisor to evaluate each other's performance. Research on peer evaluations has found them to be predictive of success and correlated with both objective and subjective ratings of success in numerous situations. A review of many studies examining the use of peer ratings in the military services found that peer ratings were more valid predictors of leadership performance than ratings by superiors. Peer ratings also have yielded good reliability and validity.[12]

The conditions required for good peer appraisals are: (1) a high level of interpersonal trust; (2) a noncompetitive reward system; and (3) opportunities for peers to observe each other's performances. When these conditions are not met, the use of peer appraisals is severely restricted. Peer appraisals are most frequently used among professional and technical employees in organizations where the conditions just listed are met. The use of peer appraisals has the potential for increasing the interaction and coordination between peers.

Self. People are always evaluating themselves. The question is how formally and systematically these self-evaluations should be recorded and acted upon. In recent years a decline in authoritarian leadership has contributed to an increase in self-evaluations in both large and small companies. Some of the arguments in favor of self-evaluation are that self-evaluation results in: (1) more satisfying and constructive evaluation interviews; (2) less defensiveness regarding the evaluation process; and (3) improved job performance through greater commitment to organizational goals.

On the other hand, the arguments opposing self-evaluations center on the fact that low agreement usually exists between self-and supervisory evaluations. Because of the systematic biases and distortions that can appear, self-evaluations have to be used very carefully. Self-evaluations are very valuable for personal development and the identification of training needs, but they are not useful for evaluative purposes. Asking employees to evaluate themselves for purposes of promotions or pay increases is like asking students to grade themselves. It puts individuals in the awkward and uncomfortable situation of trying to guess how biased others will be in rating themselves.

Clients. As a general rule, anyone who is in a position to observe the behaviors or outcomes of an individual should be included in the evaluation process. According to this principle, there are occasions when clients and customers ought to be asked for their observations. This information could come from casual complaints or letters of appreciation, or companies could systematically survey their clients and consumers.

Performance Interviews

Performance evaluation interviews can be uncomfortable experiences for both superiors and subordinates. Managers complain about the difficulties they encounter in the appraisal interview, such as explaining poor performance to marginal employees, providing feedback to poor performers who think they are doing a good job, and trying to find something fresh to say about an experienced employee's performance. They are especially threatening to insecure supervisors and new employees. Some supervisors tend to postpone interviews indefinitely, which means that the employees do not receive adequate feedback on their performance. And if the interview is handled poorly, feelings of disappointment, anger, and resentment may result. Rather than increasing performance and improving personal development, poor evaluation interviews can destroy initiative and create feelings of defeat and despair. The effectiveness of evaluation interviews will be enhanced if managers and subordinates follow some simple guidelines.

1. Evaluators should develop their own styles so they feel comfortable in an interview. If the evaluator feels uncomfortable, the employee being evaluated probably will feel uncomfortable too. An evaluator should not try to copy someone else or follow a rigid format if it does not feel comfortable and natural.

2. Both parties should prepare for the interview beforehand. Employees should review their performance and document how well they have done. Evaluators should gather relevant information and compare it against the objectives for the period. Lack of preparation for the interview by either party is an obvious indication of disregard and disinterest.

3. The evaluator should clarify the purpose of the interview at the very beginning. The employee should know whether it is a disciplinary session, a contributions appraisal that focuses on employee results, or a personal-development appraisal. In particular, the employee should understand the possible consequences of the interview so that he or she can prepare appropriate responses. For example, an employee's responses during a contributions appraisal can appropriately be a bit guarded and defensive. But in a personal-development appraisal, such responses would greatly reduce the effectiveness of the interview.

4. Neither party should dominate the discussion. The superior should take the lead in initiating the discussion, but the employee should be encouraged to express opinions. The superior should budget time so that the employee has approximately half the time to discuss the evaluation.

5. The most popular format for the interview is the "sandwich" format – criticism sandwiched between compliments. The rationale for the ***sandwich-interview*** format is that positive comments made at the beginning and end of the interview create a positive experience. The opening compliments should put the employee at ease and the closing compliments should leave the employee feeling good about the interview and motivated to do better.

6. An alternative format is to identify and discuss problems, then talk about future improvements, and finally express appreciation for good behaviors. This approach is very direct and to the point. The supervisor begins by saying, "There are ___ problems I'd like to talk with you about: ___, ___, and ___." Each problem is briefly identified at the beginning before the supervisor discusses the problems in detail. An employee immediately knows what the "charges" are and does not sit in uncertainty waiting for the next bomb to fall. After the problems have been discussed by both superior and subordinate, the discussion focuses on accomplishments for which the employee deserves recognition. The superior should describe specific actions deserving recognition and be as complimentary as the behavior merits. The interview should not end until the superior and subordinate have discussed plans for future performance. Future goals and objectives should be clarified, and plans for personal development and performance improvement should be discussed.

Employees should be encouraged to take an active role in the performance-evaluation process. Most employees wait until their superior initiates action and schedules an interview. Then they sit through the interview feeling as though they are being "chewed out," manipulated, or run over. Instead, employees should take an active role by anticipating their evaluations, collecting data about their performance, scheduling interviews with their superior, taking the lead in interviews to discuss their strengths and weaknesses, and asking for feedback. This active role makes the evaluation process a dramatically different experience for subordinates. Rather than dreading interviews, the subordinates are consciously planning for them and anticipating the experience.

The evaluation interview should focus on behaviors and results rather than on personality factors. Performance feedback helps employees achieve better results, while discussions about personality characteristics are usually dysfunctional. Because personality factors are poorly defined and value laden, discussing them usually causes bad feelings and creates unnecessary conflict. Personality changes are difficult to achieve and are usually not necessary anyway. When supervisors think a personality change is needed, what they are actually concerned about are the behaviors caused by the personality. To correct such problems, the supervisor should describe the improper behaviors and help the employee change his or her behavior. If a personality change is indeed required, feedback about the specific behavior that needs to be changed is still the best approach to changing personality.

Some have suggested that appraisal interviews should include only the outstanding and poor performers, while the middle group should be excluded. Not only are the ones in the middle more difficult to evaluate, but it appears that telling people they are average is dysfunctional. Most people resent being labeled as average when they think they are members of an above-average group. In support of this position is the finding that employees report a significant drop in organizational commitment when they are told that their performance is satisfactory, but below average.

Rewarding Performance

Compensation systems influence the overall strategy of an organization because pay has such a strong influence on job satisfaction, productivity, labor turnover, and several other processes within an organization. Staffing, performance evaluation, training and development, and employee relations are all influenced by the compensation system and they, in turn, influence compensation.

Strategic Objectives of Compensation

All employers have similar compensation objectives: to attract qualified employees, to retain them, and to motivate them to perform their duties in the most effective manner. When pay decisions are made, these six objectives have to be considered simultaneously:

1. *Legal*. The compensation system must be consistent with numerous federal, state, and local laws. Federal laws regulate overtime payments, minimum wages, child labor, pensions, equal pay for men and women, employee benefits, worker compensation, Social Security, and unemployment compensation. Some states and cities have additional regulations and all of these laws must be followed.

2. *Adequate*. The compensation system must be large enough to attract qualified employees to join the organization and stay.

3. *Motivating*. Employees are motivated by performance-based incentives. The compensation package should provide sufficient incentives to motivate employees to perform efficiently

4. *Equitable.* The employees should feel that their compensation is internally equitable relative to other employees in the organization and externally equitable relative to employees doing similar work in other organizations.

5. *Secure*. Employees like to feel that their monthly income is secure and predictable. They need to feel that their pay is somewhat insulated from changes in employment, profitability, individual performance, and personal health.

6. *Cost-benefit effective*. The organization must administer the compensation system efficiently and have the financial resources to support it on a continuing basis.

Each of these objectives is important in developing a sound compensation system; however, they are not always compatible and employers have to balance competing objectives. For example, providing an adequate wage to attract qualified employees may be inconsistent with the objective of making the wage cost-benefit effective because it requires excessively high wages. Furthermore, as wages become more secure, they become less motivating. Security is achieved by providing a predictable monthly income, regardless of performance, while motivation is achieved by paying for performance. Achieving an appropriate balance among these competing objectives, called fine tuning, is discussed later.

Wage Decisions

Employees deserve to be paid an amount that is considered just and fair. An ethical principle regarding compensation, called a ***compensation maxim***, is that employees should be compensated first according to the requirements of the jobs they perform and how well they perform them, and second by labor market conditions (supply and demand) and the organization's ability to pay. Ethical issues concerning compensation are especially sensitive because money is such an important reason why people work. People expect to be treated fairly and our concept of fairness is greatly influenced by such issues as why managers deserve more than laborers, why older workers should be paid more than younger workers, and whether people who need more should get it.

The development of a sound wage and salary system requires three basic decisions. Each decision answers a critical question regarding an organization’s compensation program. The first decision, the ***wage-level decision****,* concerns the overall level of an organization’s compensation. This decision answers the question: how much money do members of this organization receive relative to the incomes of people in other organizations who perform similar work? This decision reflects the values of the leaders of a company and expresses their desire to be wage leaders, to be wage followers, or to pay the going market rate.

The primary instrument used to help managers make wage-level decisions is a wage survey. Wage surveys contain information about the compensation and benefits of companies in similar industries or in the same geographical region. In a firm that has an average profit picture for its industry, the most compelling definition of an equitable wage is usually the “going market wage” as determined by a wage survey. Both employees and managers are inclined to accept such a wage level as equitable. The three primary kinds of wage surveys include surveys conducted by the Bureau of Labor Statistics (BLS), surveys conducted by professional organizations, and surveys conducted by individual companies.

The second decision, the ***wage-structure decision***, concerns how much pay should be awarded to different jobs in an organization. This decision answers the question: how much money is paid for one job relative to what is paid for other jobs in the same company? People typically receive more pay if they perform jobs that require greater skill, effort, and responsibility. The primary means for making a wage-structure decision is by using either a classification system or the point method. Classification systems classify jobs from simple to complex by describing different levels of skill, effort, and responsibility and there is a pay range associated with each classification. ***Classification systems*** are used extensively in public organizations, such as the GS system used by the United States government. The ***point method*** uses job descriptions and assigns points to different degrees of skill, effort, and responsibility and then the pay for each job is determined by how many points it receives. The point method is very useful for determining and defending the base pay assigned to jobs that may be very different.

The third decision, the ***individual wage decision***, concerns individual incentives and merit pay. This decision answers the question: how much money does one employee receive relative to the income of other employees who perform similar work? As a general rule, employees receive more money if their performance increases or if they have been with the company longer. Companies use a variety of incentive systems to reward employees for their performance, including individual, group, and company-wide incentive systems.

These three wage decisions illustrate the kinds of wage comparisons employees make when they evaluate their wages. Accountants in Company A, for example, compare their wages with the wages of accountants in other organizations to see whether Company A has a higher or lower level of wages. The accountants also compare their wages with the pay of bookkeepers, computer programmers, and other members of Company A to learn whether the internal wage structure offers higher pay to jobs that involve more responsibility and greater difficulty. Finally, the accountants discuss their wages among themselves to determine whether each person's wage is the same or whether differences in wages are related to productivity, seniority, education, or something else.

Incentive Systems

Incentive compensation plays a strategic role in increasing organizational effectiveness. The success of other human resource strategies usually depends on and must be aligned with an effective incentive system that creates a highly motivated workforce. Formulating an effective reward system is a very difficult task, however, because there is such a wide variety of both financial and nonfinancial rewards and because so many different reinforcement contingencies can be used to administer them. Nonfinancial rewards can be broadly classified as recognition programs.

Financial Incentives

The effects of money on motivation depend primarily on whether pay is based on performance. Companies that use direct financial incentives, such as piece-rates or commission sales, discover that they have a greater impact on performance than any other variable. In spite of this relationship, however, it is surprising to observe how seldom pay is based on performance. For example, when employees are asked what would happen if they doubled their efforts and produced twice as much, very few say they would receive additional income. Some say their supervisors would recognize their efforts and commend them, and a few think they might eventually receive a pay increase. But most say the consequences of doubling their effort would be negative: it would disrupt the flow of work, their coworkers would hassle them, and they would eventually be expected to work at that rate all the time without additional compensation.

Incentive compensation can be granted on the basis of individual performance, group performance, or company-wide performance.

Individual Incentives. The most popular forms of individual incentive pay include merit pay, piece-rate incentives, and commission sales. ***Merit pay plans*** are based upon a subjective assessment of each employee's performance, and the merit pay is typically awarded in the form of an increase to base pay for the coming year. An effective merit pay plan requires companies to have an effective performance evaluation program. To the extent that performance is more difficult to evaluate, the potential problems associated with tying pay to performance increase.

Merit pay increases are relevant to all jobs paid a fixed wage or salary. The most important requirement for an effective merit pay incentive program is the ability to measure performance against clearly defined objectives. For an effective merit pay plan to function smoothly, supervisors and managers must have the competence to evaluate employee performance and provide meaningful feedback. But even when performance can only be evaluated subjectively, most employees still believe that pay increases should be related to performance.

The most direct relationship between pay and performance generally appears in the form of ***piece-rate incentives***, where workers receive a specified amount for each unit of work. The effectiveness of piece-rate incentives has been studied for many years. Frederick W. Taylor defended his recommendations of piece-rate incentives on the basis of research showing that workers paid on a piece-rate basis produced more work and earned more money. Taylor argued that piece-rate incentive programs would increase productivity by at least 25 percent. Surveys of piece-rate plans over the past eighty years have suggested that Taylor underestimated the actual results. Most surveys have found that productivity under piece work has increased between 30 to 40 percent and in some cases greater than 60 percent.[13]

Although piece-work incentive systems predictably increase productivity, there is some question whether the increase is due to financial incentives alone or to other changes that accompany piece-work plans. Two variables that accompany piece-work programs are: (1) changes in the design of the work and (2) higher performance goals. When a piece-work plan is installed, a careful analysis of the job is usually conducted to ensure that it is being performed efficiently. A careful job analysis often identifies more efficient methods of performing the task. Moreover, when the task is being timed to establish pay rates, a goal setting process occurs, followed by performance feedback. The question, then, is whether goal setting, measurement, and job redesign are more responsible than pay incentives for increasing productivity. Studies generally show that each factor alone has a positive influence on productivity, but that the impact is far greater when all three factors are present. Thus, incentive systems contribute to productivity increases due to improved work methods, higher performance goals with specific performance feedback, and monetary incentives that induce greater effort.[14]

An alternative to paying people for what they do is to pay them for what they are capable of doing. ***Skill-based pay*** encourages employees to acquire additional skills. Companies identify a list of valuable skills they would like to encourage their workers to acquire and as the workers demonstrate mastery of each skill they receive an increase in their base pay. These skill-based compensation plans reinforce employees for their growth and development and hopefully result in more creative ideas, organizational flexibility, and quality performance.

Another alternative, called ***pay for knowledge***, provides incentives for employees to learn new information and demonstrate it by taking achievement tests. Specific dollar amounts are associated with each test and employees receive an increase in their base pay after successfully passing each test. Pay for knowledge and skill-based pay systems are vital elements in the change strategies of organizations that are experiencing rapid change or having to adapt to an uncertain environment.

Group incentives and bonuses. Although piece-work plans are typically based on individual performance, they can also be based on group production, with all members of the group sharing the money earned by the group. Group incentive plans have some important advantages over individual incentive plans, since they create greater cooperation among coworkers. This climate of cooperation usually reduces the need for direct supervision and control, since workers are supervised more by their coworkers than by their supervisors. In such a climate, slow workers are pressured by their coworkers to increase their productivity. Moreover, the flow of work and flexibility in job assignments are greatly facilitated by group incentives. When the normal work routine is disrupted because of unique problems such as illness or broken machines, individuals paid on a group incentive plan are more willing to adapt to the problem and solve it themselves.

Group incentives have certain limitations, however. When their jobs are independent, group members feel responsible only for their own jobs and think they should be paid individually. In this situation, group incentives provide little incentive to produce since extra efforts by one worker will only result in a small increase in that worker's weekly pay. As the group gets larger, this problem becomes more severe. Thus, group incentives are most useful when jobs are interdependent, when the output of the group can be counted, and when the group is small.

The powerful influence of group pressure explains why piece-rate incentives are sometimes not effective. Although many studies have shown that incentive pay systems increase productivity, other studies have found examples where groups restrict output to arbitrarily low levels. Group norms restricting productivity are very troublesome to managers and they are particularly perplexing because they seem to be so irrational. Why should a group of workers collectively decide to restrict their productivity when they are paid only for what they produce? This behavior is not so irrational when it is examined from the workers' perspective. The problem centers on how the performance standards are established. Workers know that performance standards are somewhat arbitrary. They believe that if they consistently produce more than the standard, the industrial engineer will return and retime the job. Then they will be expected to produce more work for the same amount of pay.

Management has been guilty of retiming jobs often enough in some organizations to justify the workers' fears. Several interesting case studies have described the games played by workers and industrial engineers in setting performance standards. Since industrial engineers know the workers intentionally work slowly, they arbitrarily tighten the standards above the measured times. But the workers know the industrial engineer suspects them of working slowly so they add unnecessary and inefficient movements to look busy, which the industrial engineers expect and try to disregard.

Company-wide incentives. In some organizations financial incentives are based upon the performance of the entire organization. Three of the most popular forms of company-wide incentives include profit-sharing plans, Scanlon plans, and gainsharing.

Profit sharing is the most popular company-wide incentive, and in some companies the employees have been highly motivated to perform as a result of a generous profit-sharing plan. A typical ***profit-sharing plan*** distributes 25 percent of the pretax profit to the employees according to an allocation formula that combines years of service and base wages. For example, in some plans, employees receive points for their base pay, such as one point for every $1000 of annual salary, and points for length of service, such as one point for every year of service. Profit sharing money is then distributed to employees according to their percentage of the total points.

Profit-sharing plans can be either ***cash plans*** and ***deferred plans***. Cash plans are more directly tied to performance since employees are paid annually. However, deferred plans are more popular because of tax considerations. Under a deferred plan an employee's share of the profit is held in an individual account where it grows without being taxed until it is received later, usually at retirement. Some deferred plans provide enormous wealth to their participants.

Profit-sharing plans generally reduce the conflict between managers and workers. Many companies claim that their plans have created a sense of partnership between employees and management and have increased employee interest in the company. Profit-sharing plans typically increase productivity by increasing motivation; however, the impact of profit sharing is typically less than for piece-rate plans since each individual's profit share is not directly tied to individual productivity. Immediate rewards that are directly tied to specific individual behaviors are more effective than profit-sharing plans, especially for motivating employees who have short attention spans and who cannot delay gratification. Deferred compensation plans, for example, are more effective for older workers than younger workers since retirement is not so distant.

Scanlon plans were named after their founder, Joseph Scanlon, an accountant and union steward in a steel mill. While negotiating a new labor agreement, Scanlon proposed that the percent of revenue allocated to labor costs be maintained at a fixed ratio of what it had been over the past few years. Scanlon believed that the employees would be highly motivated to increase their productivity if they knew that a fixed percent of the revenue would be paid in wages. Scanlon believed that significantly higher revenues could be obtained without an increase in the number of employee hours by motivating the employees to submit productivity improvement suggestions and to work harder. Since 1941 when Scanlon first proposed his idea, Scanlon plans have grown in popularity, and the results have shown that they tend to increase both company profits and employee wages.

Gainsharing is a company-wide incentive program similar to profit-sharing; but the bonuses are based on improved productivity rather than a percent of the profit. An effective gainsharing program requires managers to tie specific incentives to the strategic factors that determine a company's economic success, called ***business drivers***. Some examples of business drivers are occupancy rates for hotels, turn-around time and vacant seats for airlines, and inventory shrinkage for retail companies. A successful gainsharing program at an oil refinery identified targeted goals for seven business drivers and promised to share the proceeds with the workers if they exceeded these goals. The goal for safety was an incident rate of 0.5 and for each accident that didn't happen the company would put $18,000 (the average cost of an accident) into the fund to be divided among employees. Gainsharing plans normally reward employees on a monthly or quarterly basis, depending on how productivity is measured, whereas profit-sharing is usually paid annually.

Bonuses. Executives and managers often participate in an additional bonus program designed specifically for them. The basic philosophy behind executive bonuses is to reward managers for good performance. When they are tied to the overall performance of a company, the bonuses are expected to create greater creativity and better cooperation between managers.

Executive bonuses are typically larger for upper-level managers than for middle-level managers even when expressed as a percentage of salary. At upper levels of a company, a typical bonus might be 80 to

120 percent of salary. At lower levels of the company, supervisors typically receive bonuses that add only 15 to 40 percent of their salaries, if they receive a bonus at all.

The bonus plans of many companies are not carefully designed and administered. Although bonuses are intended to improve the performance of individual managers and the organization as a whole, the research evidence evaluating bonuses does not entirely support their effectiveness.[15] Because management performance is difficult to evaluate, most bonus plans distribute money based on the manager's position rather than on the manager's performance. Consequently, these plans typically do little to motivate greater performance. Even though they are very expensive and the research evidence regarding their effectiveness is mostly negative, they are still widely used.

Fine-tuning the compensation plan. In designing an effective compensation program, organizations need to find the proper balance between base pay and incentive pay, including individual incentives, group incentives, and company-wide incentives. This process of balancing the various incentives is called fine-tuning the compensation system. Compensation managers must fine-tune the compensation system just as a mechanic fine-tunes an engine. The engine needs to be adjusted for the load it must pull, the quality of fuel it will use, and even the altitude at which it will operate. Similarly, a compensation system needs to be fine-tuned to balance the employees' needs for security, equity, and motivation.

Employees who have a sizable base pay feel very secure, but they are not motivated. However, if the total compensation consists only of incentive pay, several potential problems could develop, such as increased turnover because of inadequate security, dissatisfaction over inaccurate performance evaluations, and dysfunctional competition between coworkers.

The fine-tuning process consists of adjusting the base pay, individual incentives, group incentives, and profit-sharing to create feelings of security and motivation. Security is provided by a stable base pay that provides a dependable weekly or monthly income. Equity and motivation, however, are provided through incentive plans. Some organizations choose to pay large base salaries and give small bonuses, while other organizations do just the opposite.

Recognition Programs

Nonmonetary reward systems have been used effectively to improve employee motivation. Every motivation theory agrees that praise and recognition are effective rewards. Companies have created a variety of nonmonetary reward programs to recognize employees, and some of them have been more effective than monetary incentives. The following illustrations demonstrate the diversity of recognition rewards.

> —A storage company paneled one of its walls inside the warehouse and used it to display the photographs of the employee with the best safety record each month. The number of accidents in the warehouse was greatly reduced, and the forklift operators were pleased with the recognition they received, even though the public could not see their photographs.
>
> —Sewing machine operators receive silver stars on their nameplates if they exceed 120 percent of their production quotas every day for a week. After they get ten silver stars, they receive a purple seal. Ribbons are awarded for high-quality production, and the operators display them with pride.
>
> —A hospital gives five-, ten-, fifteen-, twenty-, and twenty-five-year service pins to recognize employees for their years of service. The pins are top-quality jewelry made with diamonds and gold that show the hospital's logo. When the price of gold increased, the hospital decided to give savings bonds rather than pins, but the administrators abandoned the idea when they discovered that the pins were far more important and valued by the employees than the savings bonds.

—To reduce absenteeism and tardiness, a small apparel manufacturer decided to give gifts of ten to fifteen dollars to randomly selected employees who had perfect attendance. At the end of each week, the names of those who had perfect attendance records were placed in a drawing. For every twenty names in the drawing, one name was selected to receive a gift. After three months, tardiness was only a third of what it had been, and absenteeism was cut in half.

Recognition awards, such as silver stars, purple seals, and photographs hung on a wall, are not inherently rewarding. Primary rewards such as food, water, rest, and the removal of pain are reinforcing because of their relationship to the innate physiology of the body. However, secondary rewards such as recognition awards do not directly satisfy physiological needs. Instead, they become powerful reinforcers as people come to place value on them. Consequently, social approval, recognition, status, and feelings of pride and craftsmanship are secondary or learned rewards because their reinforcing properties are acquired through experience with them. Although a person may not immediately see the secondary reinforcer as a highly motivating award, over time it can become a powerful form of reinforcement. Recognition awards are often inconsequential to new employees, but as new workers observe their coworkers participate in meaningful recognition experiences, the reward comes to be a highly valued reinforcer. For example, a twenty-five-year service pin can be an extremely motivating reward, not because of its financial worth but because of the symbolic meaning associated with it. In some organizations the service pins are distributed at an annual awards banquet where the recipients are recognized individually. Employees who observe this ritual year after year come to appreciate the ceremony and see the pin as a highly valued reward.[16]

Intrinsic Versus Extrinsic Rewards

Some scholars are opposed to using any form of monetary incentives to motivate workers. Indeed, they adamantly condemn all extrinsic reward programs that are designed to motivate people or change their behavior, including piece rate incentives in industry, grades in education, and gold stars in child rearing. Their argument is not that incentives do not work, because they admit that well-designed incentive programs can have an immediate and substantial impact on behavior. Their claim is that they work for all the wrong reasons. Six of the most important reasons are:[17]

1 *Rewards are used to control behavior*. Rather than encouraging people to direct their lives according to their personal values, rewards are used to manipulate and control them. Rewards are effective only for people who are dependent on them and they only work if they continue to be received.

2 *Rewards punish*. Rewards and punishment are both elements of a common psychological model that views motivation as nothing more than the manipulation of behavior. To not be rewarded, or to be rewarded less than last time, is to be punished.

3 *Rewards rupture relationships*. Competition for rewards within a group tends to destroy group cohesiveness. Also, the relationships between the person giving the rewards and the recipients are also damaged due to the unequal status position inherent in the situation.

4 *Rewards ignore reasons*. Successful performance is determined by both personal and situational factors, and when rewards are based strictly on performance the uncontrolled situational factors that may have prevented success are ignored.

5 *Rewards discourage risk taking*. When people are competing for rewards they overlook new opportunities and creative insights for improving performance and focus primarily on customary methods.

6 *Extrinsic rewards destroy intrinsic satisfaction*. The good feelings people have for performing a task or helping others are destroyed when they are given extrinsic rewards.

Since people have to be paid to work and rewards serve many useful purposes, those opposed to the use of extrinsic rewards offer the following suggestions to minimize the damage caused by extrinsic rewards:

1. *Get rewards out of people's faces*. Encourage people to perform well without continually talking about the potential rewards. Focus on the intrinsic satisfaction of providing service and assistance.

2. *Offer rewards after the fact, as a surprise*. Rewarding excellence with unexpected rewards prevents people from feeling that they were only motivated by the rewards.

3. *Never turn the quest for rewards into a contest*. Contests reward some at the expense of others.

4. *Make rewards as similar as possible to the task*. The best reward for good behavior is the opportunity to do it again and feel good about it.

5. *Give people as much choice as possible about how rewards are used*. If possible, let people suggest what will be given, to whom, and when.

Discussion Questions

1 Since employees dislike being evaluated and supervisors dislike evaluating them why should companies evaluate employee performance? Students also dislike being graded. What would most likely happen and how would you respond if grading were eliminated or if all students received A grades?

2 Describe the conditions that contribute to effective performance appraisal interviews. Identify a time when someone has evaluated your performance and discuss what you liked and disliked about it and whether it was helpful.

3 Which organizational conditions are best suited for using individual, group, and company-wide incentives? Identify a specific job and explain what percent of the pay for that job should come from base pay, individual incentives, group incentives, and company-wide incentives to balance the objectives of motivation versus security.

4 Do you agree that extrinsic rewards, such as money, destroy intrinsic motivation? Describe a time when you received an extrinsic reward and explain its impact on your intrinsic motivation. What are the effects of financial incentives on motivation and how do you recommend employers use money to increase motivation?

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