Monetary Incentives linked to Apprisals

(Systemic Implications Revealed)

By Gene Gendel

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"The idea of a merit rating is alluring. The sound of the words captivates the imagination: pay for what you get; get what you pay for; motivate people to do their best, for their own good. The effect is exactly the opposite of what the words promise."
-Edward Deming, "Out of Crisis"

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I wanted to start this discussion with Wikipedia definition of Performance Appraisal:

"*A performance appraisal (PA), also referred to as a performance review, performance evaluation,[1] (career) development discussion,[2] or employee appraisal[3] is a method by which the job performance of an employee is documented and evaluated. Performance appraisals are a part of career development and consist of regular reviews of employee performance within organizations."*

Interestingly enough, while all three terms are being included in the same definition ("*review*", "*evaluation*", "*appraisal*"), in practice, companies predominantly use the term "*review*" to describe PA as it implies less scrutiny and preconception towards an employee. But does this change the essence of the process if a less abrasive term is being used?

Usually, PA process starts with setting individual career goals by an employee. Of course, this is not done in a vacuum of what an employee only chooses for herself. Individual career goals should be in-line with organizational/department career goals, usually set by management. It is expected that throughout a year, an employee has to *steer* herself towards set goals, while performing her day-to-day job responsibilities.

Every company that supports PA process has a scoring system (variations exist) to rank employees, against other employees, based on score that an employee earns, while performing her yearly accomplishments (goals set vs. goals achieved). Some organizations offer a mid-year (quarterly, at best) check-point to employees, at which an employee reviews with her manager how she is performing with respect to the goals, set originally. Practically, no companies handle PA as an actively managed, iterative agile process.

For most companies the whole PA process, typically serves the following three main purposes:
1. To identify low-performing employees that are potentially a subject to downsizing
2. To identify high-performing employees that are potentially a subject to promotions
3. To decide how discretionary incentives (bonuses) can be distributed among employees

While on the surface PAs still appear as an effective way ensure quality of employees and provide benefits to organizations, under the surface this process presents real challenges. These challenges become more visible at organizations that are in the process of adopting agile culture, since in agile environments systemic organizational dysfunctions get exposed much better.

But before we dive deeper in the discussion, let us first briefly refer to some credible research and studies that exists today:

In his book "Out of the Crisis", originally published in 1982, Edward Deming discusses Seven Deadly Diseases of Management and refers to individual performance reviews and performance evaluation as *Disease # 3*. Deming's philosophy of transformational management is about seriousness of barriers that management faces today, while improving effectiveness and striving for continual improvement. Deming argues that trying to evaluate and measure workers with the same yard stick causes more harm than good to individuals and companies.

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Tom Coens and Mary Jenkins offer specific suggestions on how to replace performance appraisals with a more effective system that emphasizes teamwork and empowerment in their book "Abolishing Performance Appraisals: Why They Backfire and What to Do Instead. Coen and Jenkins discuss new alternatives that produce better results for both managers and employees.

In his Forbes article "Eliminating Performance Appraisals", Edward E. Lawler III, a distinguished professor of Business at the University of Southern California, advocates that organizations stop doing performance appraisals. Professor Lawler states that performance appraisals frequently do more damage than good, with damage levels fluctuating between wasted time (least troublesome) to reasons for alienation of employees and creating conflicts between them and their supervisors (most troublesome).

Garold Markle, an author, executive consultant and speaker, leverages his studies and experience with systems theory to illustrate his points with real-life examples of why employees and managers both have come to believe the "ubiquitous performance evaluation as industry's poorest performing, most ineffective, and least efficient personnel practice". In his book "Catalytic Coaching: The End of the Performance Review". Markle provides an innovative way to measure ineffectiveness and inefficiency of performance evaluations and then introduces his catalytic coaching to replace them. His statement is awakening: "People hate performance reviews".

In his book "Drive", Daniel Pink offers a paradigm-shattering view on what truly motivates people in their lives. Pink draws on four decades of scientific research on human motivation, to expose a mismatch "between what science knows and what business does". Pink challenges the mistaken belief of many that people doing intellectual work, will demonstrate higher performance, when incentivized monetarily. Bas to Pink's research, it becomes clear that individual performance evaluations and individual appraisals that are linked to monetary rewards, are not an effective way to steer individuals to become more efficient and productive. Therefore, they should be abolished. And the list goes on….

So, now lets take a closer look at the problem, with some specific examples:

Fabricating Goals to Game the System

Are goals that employees officially set for themselves (in a system of record) truly reflect their genuine, personal goals?

It is not uncommon that real personal goals are risky and challenging to achieve or may take longer than initially expected. Many other goals can be also situational or opportunistic: they may change as a situation changes or unforeseen opportunity presents itself (job market trends, other job opportunities, personal life). People want to have freedom and flexibility to adjust their goals to optimize their personal benefits; this is a human nature. There is no true personal benefit for an individual to "set in stone" her goals into a personal development plan at year-start and then having to deal with unpleasant consequences at year-end, IF she does not meet her goals. In general, in order to set her real goals, a person needs to know that it is safe to actively manage them along the way and, if needed, safely change and/or fail them, without fearing negative consequences.

But is there any safety with PA processes if job security, career advancement ability and ability to collect fair compensation are at risk? If there is no personal safety, the exercise of setting personal goals becomes nothing but a routine of faking objectives that are "*definitively achievable*". People are forced to do it, to minimize the risk of being scrutinized by their management for not meeting their goals. Setting individual goals becomes just a formality that brings no true value to an employee.
The process of individual performance reviews becomes even less meaningful if people work in small teams, where swarming and collective ownership is important, and joint delivery is expected. In cases such as these, people are forced into unhealthy competition with each other over goals, trying to privatize what should be owned and claimed collectively.
Another challenge with evaluating employees' individual career goals is that in pursuit of personal goals, people frequently "drop the ball" and de-prioritize common goals. Again, this dysfunction becomes much more vivid in going-agile environments, where agile frameworks (e.g. Scrum, Kanban) de-emphasize individual ownership and reinforce the importance of collective ownership. Often, close to mid-year and end-year performance reviews, collaboration and mutual support of team members worsens, as silos get created and everyone begins to think about their own goals, at expense of shared goals. This translates into inefficiency and productivity drop: swarming, velocity and throughput go down; cycle time and queues grow; handovers take longer.

Example:

Jane is an employee of a large insurance company. She is being requested to enter in a company's system of record her personal goals – things that she intends to achieve throughout a year. Jane is smart and in order to avoid any unwarranted risk, where her personal success depends on success of others, she creates goals that are free of dependencies. Jane creates a set of personal goals that other group members do not know and don't care about. Her line manager John, also discourages Jane from sharing such information.

However, Jane does not work alone. Her day-to-day work is tightly coupled with work of other individuals in her group: Jim, Jeff, Jill, Joe and Julie.

Jane really values team work. She also feels that by closely working with her group members, by swarming and sharing day-to-day activities she can earn a lot more than if she worked by herself. This is where Jane decides to put her full focus: on team work. She does not feel that creating an additional set of personal goals can add real value to her professional growth. But Jane needs to "feed the beast": she needs to provide her line manager with a list of "achievable" bullets that the latter can measure. At the same time, Jane does not want to create a conflicting situation with her colleagues, by diluting her focus on shared goals by shifting it personal goals. Therefore, she fabricates her personal goals: "quick kills" and "low hanging fruits" – something that she can easily claim as her "achievement", without jeopardizing common interests of her team. Jane is forced to "game" the system to minimize harm to herself and her team.

In his book "Tribal Leadership", David Logan describes five tribal stages of societal evolution. According to his research, corporate cultures typically oscillate between **Stage 3** ("*I am great and you are not*") and **Stage 4** ("*We are great and they are not*"), with agile organizations trending more towards Stage 4. When individuals are motivated (a.k.a. "manipulated") to think

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more about individual performance than about collective performance, they mentally descend to Tribal Stage 3 and, as a result, drag along their organization to this lower stage. It is very important for organizations and their senior leaders to understand that motivation is one of the most important factors that drive evolution of corporate culture.

Note: To understand how Motivation Evolution (defined by Daniel Pink in “Drive”) relates to Tribal Evolution (defined by David Logan in “Tribal Leadership”), please refer to this tool.

Unhealthy Competition, Rivalry and Jealousy

Let’s face it, overemphasizing individual performance evaluations and allowing them affect job security, promotions and compensation of individuals does not come free to organizations. It comes at high expense of lowered collaboration, unwillingness to share knowledge and provide peer-to-peer support, increased selfishness and self-centric behaviors. For individuals that are encouraged to work and produce collectively (e.g. Scrum or Kanban teams) uneven performance evaluations frequently result in jealousy and feelings of unfair treatment. These dysfunctions become more frequent around times when employees are due to mid-year and end-year reviews. PAs have adverse effects on individuals’ ability to focus on work and, as a result, produce high quality products and think of customer satisfaction.

It is worth mentioning, ironically, when dysfunctions are uncovered, it is agile that becomes the target for blaming.

But agile is hardly at fault here as it only provides transparency and reflection of already existing dysfunction.

Example:

Jane works alongside Jim, Jeff, Jill, Joe and Julie. All of them are smart, self-motivated and talented technical experts that cumulatively have more than 70 years of software development experience. Their work is intense: there are lot of deliverables and their timeframes are rigid. The group serves the same client for a number of few years and, so far, a client is happy. The work that this team performs, requires a lot of collaboration, collective thinking and brainstorming, teaching/learning from each other and, of course, collective delivery.

But then comes a mid-year review period and Jill notices that Jeff is not as supportive of her as he was at the beginning of the year. Jeff becomes less responsive to Jill’s requests, he does not share his knowledge as readily as he used to; he does not give advice. Tasks that used to be handled collectively by Jill and Jeff are now illogically split by Jeff as he tries to focus only on what he assigns to himself.

There is also a noticeable change in Julie’s behavior. Julie becomes very eager to be the one who stands in front of a client and presents deliverables of the whole team. This responsibility used to be rotated from one person to another, with no one caring too much about being a “spokesman”. But as mid-review came, Julie clearly stepped up to be the main, customer-facing presenter. Julie also tries to make it very obvious to John (the group’s manager) that it is her – Julie, who presents to a customer. Julie wants to be viewed as a “centerpiece” and gain most of spot light.

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Jim's contribution to the group's efforts have also subsided. Early in the year, Jim used to be a very active participant at the team's brainstorming meetings and workshops. As mid-year arrived, Jim started spending a significant portion of his time working on items that are not related to the team's shared work; his focus has noticeably shifted to personal work that he does not even discuss with others.

Since the beginning of the year, it has been customary for the group to go out for drinks to a local bar, every Friday. But this tradition is now barely followed, at mid-year period. There seems to be less desire for the group to socialize outside work settings. Everyone finds an excuse not to make it. The group's synergy has gone down noticeably. What used to be a well jelled team of great collective performers has turned into a group of self-centered individual achievers that want to be acknowledged for their heroics.

"Scripted" Ranking to Force-Fit into Bell-Shaped Curve

Typically, when an organization ranks its employees based on individual performance, a bell-shaped curve is produced, where *samples* (ranked employees) are binomially distributed around the median: majority of samples are centered ("center mass"), representing average performing employees, left tail – representing low performing, and right tail – representing high performing (over-achievers). Statistically, a bell-shaped curve is a normal distribution of any large sample. The symmetrical shape of a curve ("bell"), however, can be influenced by additional three main factors (forces):

- *Platykurtic distribution* - it lowers amount of samples around the median (average performers) and increases amount of outliers (under-performers and over-achievers), equally on both sides. A curve remains symmetrical.
- *Leptokurtic distribution* - it increases amount of samples around the median (average performers) and lowers amount of outliers (under-performers and over-achievers). A curve remains symmetrical.
- Uneven distribution of samples on left and right sides from median – Typically, this increases amount of samples on left (under-performers) or right (over-achievers) tails of a curve, while also disturbing symmetry of a curve and evenness of sample distribution around median (average performers). A curve loses its symmetry

This statistical distribution is tightly coupled to actions that management takes towards its employees at year-end. However, the shape of bell curve, does not "drive" (as it might be expected) managerial year-end decisions; it is rather *driven by* them.

Managerial decisions are driven by financial conditions of an organization as well as other strategic organizational plans. When managers review their employees, they have to account for such factors to make sure that a bell-shaped curve does not exceed organizational capabilities of promoting too many employees and giving out too much money. Effectively, the entire process of performance assessments becomes a retro-fitting exercise that shapes a bell curve, basing it on organizational capabilities. This makes the process, practically, staged or "scripted". What further ads to the irony of this situation is that at times an employee may report into a manager that does not even have sufficient skills for perform an objective assessment of an employee's performance. For example, an architect or a software engineer that reports into a non-technical manager (e.g. PMO) has a much lower chance to objectively discuss her work accomplishments and receive an objective feedback during PA.

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There is a need for an alternative approach that will help dealing with overly complex, over-staffed organizations that spend so much time and energy trying price-tag its employees.

Here is an idea: how about more thorough checks of background and references, more rigorous interviewing processes that involve practical (hands-on) skills assessments, try & buy periods, before hiring an individual full time or some other, more objective methods?

Instead of attracting cohorts of workers of questionable quality and then dealing with inevitable force reduction or worrying (or pretending to worry!) about employees maintaining and/or improving their quality, hiring managers should be striving to acquire and retain lower *quantities* of higher *quality* workers: self-motivated, enthusiastic professionals, with a proven track record and clearly defined career goals…AND be willing to pay them higher compensations. This may require offering more competitive base salaries, and abolishing manipulative discretionary incentives: removing money from the table makes intellectual workers think more about work, and less about getting paid. This approach would also ensure that quantity of employees is kept at a minimum (this also ensures lowering overhead, complexity reduction, organizational descaling), while maximizing quality. Such alternative should render performance reviews much less important or even obsolete as there will be no need to reduce employees at year-end or thin-slice discretionary incentives among too many candidates.

Example:

John is a line manager for the development group. John has great organizational skills, he is well spoken and can greatly articulate his thoughts. But John, has never developed software products; he is not technical. John knows that all of his team members are "good guys": knowledgeable, enthusiastic, and mutually supportive. But when the team works together, John really cannot validate quality of work that they produce. (Luckily, there is one reliable measurement of the team's success – it is customer satisfaction). The only thing that John can validate is the team's vibe and spirit. But even when John notices disagreements or temporary misalignment among the team members, it is impossible for him to offer a constructive advice or understand a root cause. What is even more challenging and frustrating for John is that due to the nature of team's work (closely collaborative, collectively shared) he cannot objectively assess individual performance of every team member. In conversations with John, the team members rarely use the word "I"; it is typically "we".

John is in a tough position. How can he decide who the best performer on his team is and who is not? John needs to be able to 'rank' his people and based on ranking, decide who gets promoted and paid more at the end of the year. Deep at heart, John feels that everyone deserves a promotion and monetary "thanks" but he cannot satisfy everyone. John's management informs him that only one person from the team can get promoted and the amount of incentive money allocated to his group is limited; in fact, it is less than last year.

Around mid-year time, John begins evaluating how each of his team members has performed up-to-date. John does this based on "achievable" goals that were set by each employee at year-start. John's inability to truly understand the nature of peoples' technical work adds to his challenge…and frustration. He cannot objectively evaluate his employees, let alone rank them against each other.

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Meanwhile, John's management expects from him a ranking model that will fit into a bigger picture of organizational capabilities to give promotions and bonuses, for a given year. It means that even if John feels that all of his members are outstanding performers he will not be able recognize this officially. At most, he will be able to recognize that they have achieved their set goals. Further, based on what John learns from his management, he has to commit even less unpleasant act. Learning that certain percentage of a company's workforce has to be reduced, John has to identify and set up for possible future downsizing some people from his group. It is clear to John that people that are outstanding performers are not the best candidates for downsizing (potential HR cases). Therefore, John decides to force-fit some of his team members into bell-shaped curve, away from the right-sided tail, towards the middle (average performers) and left-sized tail (underperformers). John uses organizational "script" to play his own team. What John does, is a wasteful act that is full of subjectivity and ambiguity. The process is also destructive to the team's cohesiveness and morale. John is at risk of losing some good people sooner than he could expect.

Generating Waste

Rarely, do companies consciously analyze how much time and effort is being spent on performance evaluation process by employees, line management, senior management and HR. Unfortunately, for large, enterprise-size companies, these expenditures are already "budgeted for". From the standpoint of lean thinking, today's typical process of PA is conducted by line managers is a clear example of organizational overhead that slows corporate cultural evolution and prevents companies from maturing to Tribal Stage 4.

Example:

All members of the team: Jane, Jim, Jeff, Jill, Joe and Julie spend a lot of time during the year writing and reviewing their personal coals. John spends a lot of time reviewing and discussing personal goals of every team member. John also spends a significant portion of his time with his line management, discussing achievements and intended ranking for each of his subordinates. Overall, the amount of time this entire group of people spends on the PA process creates a lot of unnecessary procedural overhead and over processing.

Alternative Approaches to Performance Reviews

Are there any working solutions to this problem? Is it possible to ensure that organizational behavior towards employees (e.g. motivating and incentivizing) is more in-line with what is best for organizational prosperity, business satisfaction, waste reduction and the creation of more pleasant work environment and Kaizen culture? Is there a way to depart from archaic norms and behaviors gradually, without causing too much stress to an organizational ecosystem, perhaps, by offering alternative, less harmful, interim solutions?

First, lets be clear: a natural "knee-jerk" reaction of any employee when she is told by someone why she is not "perfect" and what she needs to do to improve is defensive. Of all reasons, the biggest reason why she would become defensive is her resentment that someone will subjectively "evaluate" her and decide how much she must get paid. Although an individual

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may keep her feelings and emotions concealed under the umbrella of political correctness and diplomacy deep under covers, there is emotional harm being done.

The end goal of any organization should be to abolish performance appraisals completely and substitute them with other, more effective methods of individual motivation.

But for now, lets look at some interim alternatives that can help us depart from individual performance appraisals gradually, by moving to less harmful approaches.

Here are some potential, interim (short term solutions) alternatives of how co-dependency between individual PA process and incentives allocation process can be dissolved (graphics are here):

- Instead of prizing individuals - prizing teams and do this based on what an entire team produces, not a single individual. If individuals must work in tight collaboration and are expected to cross-pollinate with expertise and produce together, what is the point to stress individual performance and heroics? Let a team, internally, decide who is elevating them and who is submerging them. Individual underperformers will be quickly identified in such settings, and a team will try to either expel them or help them to improve. Also, please note that prizing a team (monetarily, team bonus) does not have to be coupled to "performance assessment". This could be done, simply, as a profit sharing model between business and technology: if work of technology has noticeably improved the bottom line of its business partners, the latter should be happy to prize hard and successful work of the former.
- Take away singleton decision making capability of defining a team deserves in terms a "monetary prize" out of line managers' hands and "spread the wealth" across multiple parties: make it based on customers/stakeholders satisfaction, senior management satisfaction, third party feedback, etc. But again, judge teams, not individuals (important!).
- Make monetary incentives allocation more objective and formula-driven, than subjective and single opinion-based. Here are a few "formulas" to achieve this:
    a. Monetary Incentives Are Equally Allocated among all employees whose work is tightly coupled and collective ownership is expected
    b. Monetary Incentives Are Allocated in Proportion to Base Salary of an employee: decide on employee's "worthiness" when she is hired (based on expertize, experience, etc) and then fall back on formula "a")
    c. Monetary Incentives Are Allocated based on Team's Internal Voting, done confidentially (incremental, 360 review by all team members).

Note: Consider the above options as short-term, interim solutions on the way to completely abolish conditional monetary incentives. Although, team-level incentives are less dangerous than individual incentives, they still carry harm in them: they make people think of getting paid, not about doing work. Ideally, for any kind of intellectual work, money should be removed from the table: a person should be focused on doing work, not on how to get paid.

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Conclusion

The famous quote from the book "Out of Crisis" written by Edward Deming (originally published in 1982) summarizes this topic well:

> *"The idea of a merit rating is alluring. The sound of the words captivates the imagination: pay for what you get; get what you pay for; motivate people to do their best, for their own good. The effect is exactly the opposite of what the words promise."*

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- Get Rid of the Performance Review!

Biography

Gene Gendel is agile practice leader and transformation agent. He proudly carries the credential of Certified Enterprise Coach (CEC), and Certified Large Scale Scrum Practitioner (LeSS).

Genes' primary focus is on helping organizations and teams with adopting agile culture, improving tools, techniques and processes in development. His focus is also on organizational and cultural improvements, mid-level management and team-level coaching and training. His coaching style combines training, mentoring and leading by example.
Gene am an active member of NYC agile community where he is known as a big proponent of community-wide, cost effective agile education. He attempts delivering such education "to crowds" via personal presentations, organizing open-space agile collaboration workshops, group meetings and other community activities. Gene strongly emphasize the importance and abide to 'ethics of agile coaching'.
Gene started his professional journey about 17 years ago in the area of analysis and management and transitioned into agile area about 8 years ago:

Here is the list of Gene's main focus areas:

- Converting Corporate Culture to Kaizen
- Economics of Product Development
- Agile Product Ownership and Management
- Mentoring, Coaching, ScrumMastering
- Scrum, Kanban

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Below, are some highlights of Gene’s community contributions:

- Founder, manager and supporter of Agile Program for PMINYC
- Facilitator, Speaker and Panelist at Agile events:
- IIBA NYC Chapter, Agile NYC Group, SPIN Group, PMINYC
- Agile Community Servant

Gene’s professional certifications are:

- Certified Enterprise Coach (CEC)
- Certified Large Scale Scrum Practitioner (LeSS)
- Certified Scrum Professional (CSP)
- Certified Scrum Master (CSM)
- Certified Project Manager (PMP)

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