Business Ownership White Paper

PERFORMANCE REVIEWS
BEST PRACTICES

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Why a White Paper?

A white paper is an authoritative report to educate and assist people in making decisions. I issue white papers when the subject matter is important to business owners, but it is too technical or complex to address in the length of an article or blog posting.

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PERFORMANCE REVIEWS
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Performance reviews are a pain. In my nearly 40 years in business they have always generated the same complaints. Managers hate to do them. As a consequence, they are frequently over due. They provide the employee with little information on how to improve. They are written to match decisions that were already made, like a promotion, a big raise, or a small one.

I was auditing one of our business owner peer groups (The Alternative Board®) when one of the members presented his issue. His family business had never had an employee review process that worked. Every time it was tried, it was either dropped ("We're too busy.") or perverted ("He grades all his employees higher than I do mine, so they can get bigger raises.") "What" he asked, "are the components of an effective review process?"

In all honesty, I know only a few companies that do a *really* good job of reviewing employee performance. I've examined each one carefully, and determined some factors that their processes had in common.

Defining a "Good" Performance Review

First, let's determine what we should expect from a good performance review.

- It creates a dialogue that is honest, open and consistent.
- It actually gives both the employee and the manager useful information.

- It sets expectations, and allows both parties to measure progress against defined parameters
- It improves performance

As an owner, I'm pretty sure you would gladly accept the above results from a review process. You may have something to add, but these form a good baseline.

Looking at the companies that execute reviews in a manner which accomplished the objectives listed above, I found some distinct similarities.

All Reviews are Done at the Same Time

For many, that is at the end of the year, when things are a bit slower, but that time isn't universal. Some organizations have other slow seasons; some prefer a different point in the business cycle. In all cases, the reviews are done for all employees at a scheduled time.

The advantages are several. First, there is no tracking required. Every employee knows exactly when their review is due. There is no ducking or delaying. Managers all the way up the line know it is review time, and submission of them is company-wide. There are no "ambush" reviews, and no questions between subordinates and supervisors about whether a review is being delayed.

There are also disadvantages. It affects productivity. The review process becomes a focus for a month or so and other work can suffer, particularly for

managers. There is a small issue of "short" reviews, where employees in their first year may complain of not having enough time to show their best work, but that is minor. If compensation adjustments come shortly after a review (Not with a review- see further down!) then there is a hit to the cash flow that has to be budgeted.

Reviews are Hard Work from the Top Down

In every company that I am profiling, the managers dread "performance review time." Just because the process is valuable and effective doesn't make it fun; it's still hard work. It takes strong leadership from the top to keep it on track and make it effective. There should be consequences for managers who don't comply with the process.

It's tough to discipline a manager who is great performer (which is usually why they got the job) but won't get in line with the company review policy. They frequently push back with "Do you want me to push paper, or make the company money?" "I can do those reviews, but you have to tell me which customer's order you want to ship late."

The commitment to performance measurement has to start at the top. I know one company that insists on reviews for all employees…right up to the Director-Vice President level. Those employees ask for reviews as well, but the C-level executives say "You must be doing a good job. Your review is in the bottom line every month."

Bull. Those employees know that they all don't contribute equally to the bottom line, and want individual recognition. They are tempted to consider the

down-line review process to be busy work, put in place to make a show of caring about performance. The top executives are sending a message. "At a high enough level, we don't have to follow the mission/vision/values thing if we consider it inconvenient." Is that the message you want to send?

Reviews are for Performance, Not Compensation

Performance evaluation is what it says. It isn't called compensation evaluation. In recession like we had in '07-'09, there may be no raises. That doesn't mean there should be no reviews. Many companies are recovering slowly. Their tradition of tying reviews to pay raises has them ducking the reviews, because they can't yet afford increases.

Linking pay and performance (not pay-for-performance, which is a different thing) is logical, but the steps of the process have to be separated. Managers *like* to discuss compensation in reviews. It often gives them an "out" for any criticism they hand down. "You dress like a slob, Cathy, and your work looks the same. You are here every day on time, however, and so I'm giving you 50 cents an hour."

It is tempting to use a cost-of-living increase like a merit increase. The company decides that to remain competitive they will give an across-the-board 5% increase in wages, so they tell the managers to do reviews, and hand out the raises. Here's news: the employees aren't fooled into thinking every one of them showed the exact same merit.

The most important reason not to discuss compensation in reviews, and one that is important enough to stand alone as justification for never, never

discussing pay in a review, is Human Nature. When the employee knows that the review will end in a compensation announcement, they hear nothing else. Here's what it sounds like:

"Bob, we have looked at yadda yadda blah blah. You blah blah for a long time yadda blah yadda. So we've been thinking (*ears perk up- time to start listening*) that you should receive an additional $370 a month because (*listening stops*) yadda yadda blah blah blah."

Begin with Self Evaluations

Any review process must begin with what the employee thinks about his or her own performance. Once again, the resistance to this is usually with the managers, not with the employees.

Managers fear that employees will over-rate themselves, creating a review process that degrades to a rebuttal of "Why I don't think you are as good at your job as you think you are." That is seldom the case. Most employees are pretty honest about how they do what they *think they are supposed to be doing*. A self-review is a terrific place to discover that the employee may have a different perception of his or her duties.

If previous reviews had well developed goals and objectives (we'll get to that) it is difficult for the employee to claim an achievement that plainly didn't

happen. Knowing that they will be asked to rate themselves on goal accomplishment helps keep their eye on the ball for the whole year.

The self-review also puts the first step of each-year's process in the employee's hands. When timing is individual, it becomes an easy excuse for delay. "I can't do your review yet, Sally. You still haven't done your self-evaluation." Weeks and months can slip while the employee frets over what to present to her manager. When the whole company is engaged in the process, it is harder to hide.

Yes, when the whole company is engaged, the employees might discuss self-reviews with each other. That's fine, and perhaps great. They are far, far harsher critics of each other than their managers are. One may rank himself highly on dependability. It could fly when presented to the manager, but not with the co-worker who has to cover his station every time he takes a break.
As to the employee who is delusional about her own performance, or who thinks the self-evaluation is a starting point in negotiating a compromise score, those are different problems. I've never seen an employee submit an overblown or fantasy self-report that wasn't already evidencing other problems on the job.

The self-evaluation should be submitted to the manager before scheduling the review meeting. The manager should have ample time to review it and make measured comments. Having the employee walk in with a review to put side-by-side with the manager's invites negotiation, and is a recipe for disaster.

Scoring a Performance Review

Putting a numerical value to an opinion isn't easy for most people. The exception may be that movie critic in Steve Martin's "*L.A. Story*" who rates everything on a five-star scale. "I gave lunch a two, but the waiter was a three and a half."

Scoring underlies all the pain and problems of the review process. How do you tell an employee who does as he is told, shows up on time, and takes the occasional initiative that he is a three? "Gee, that's at least a four. He learned a couple of new things this year, and fixed that absentee problem. Last year I gave him a four. Maybe it should be a five."

Defining what a score means is challenging, but not impossible. I use a 4 point scale, so:

1. **Termination imminent.** This area must improve within 30 days, or employment will cease, regardless of other scores.
2. **Not satisfactory.** This is either because performance is below measurable norms, or because progress hasn't gone according to expectations. (This is a rating that should be utilized for employees who are doing everything exactly like last year - no progress means no raise.) A "2" doesn't indicate termination, but several of them might, and it certainly indicates a detailed improvement plan.
3. **Satisfactory.** The employee accomplished the goals as outlined, showing progress and greater competence. This isn't a "Gentleman's C." In a company that takes pains to communicate expectations of improvement, a 3 means you are doing well.

4. **Excellent.** The employee has accomplished all that was expected, and more. This may qualify for advancement, or a path to advancement if appropriate. If not, it should indicate that planning for a change in job description is in order.

Note that there are only 4 scores. I dislike odd numbers, because they make it too easy to take the middle road. Either an employee is doing what you expect, or he isn't. For the same reason, don't permit fractional or decimal scores. You are either doing what the score calls for or you aren't. There is no "pretty close." In business, we don't give trophies for just showing up.

Don't average the scores! It is tempting to give an "overall" performance rating. That defeats the purpose of the evaluation. A couple of 4's combined with a couple of 2's don't add up to an employee who is a 3.

One company I work with has a refresher meeting for all managers and supervisors before each review cycle. By sitting together and discussing how they would rate certain performance, including real-life illustrations of employees they all know, they achieve greater consistency across different departments.

Evaluation Criteria

Now you have a scoring methodology, but what do you score on? The two schools of thought lean towards either job-description-specific criteria, or general behavioral criteria.

If you choose job specific, make sure that the wording matches as closely as possible the written job description. It is a useful exercise, since many job descriptions are vague and have no performance standards. Those need to be rewritten. (I told you this wasn't easy.)

I prefer behavioral criteria. It is a fact that we hire for skills and fire for behavior. How many people are terminated because they turned out to be unable to type, or to keep books? Most are fired because they are sloppy, or don't get along with others, or have a poor work ethic. That's what you should be evaluating. Technical skills can be covered in the goal process.

Here are a few behavioral criteria that you can rate:

- Works together with other employees in a team environment
- Able to execute assignments without supervision
- Shows initiative by seeking additional responsibilities or suggesting improvements
- Solves routine challenges with an understanding of the company's vision and values
- Communicates well with both supervisor and direct reports
- Shows leadership to new employees and co-workers by attitude and example.

These behavioral criteria allow for a standard review mechanism across all jobs and functions. They create discussion about what <u>kind</u> of an employee someone is, rather than how well they execute the technical requirements of the job.

Setting Performance Goals

The objective of a performance evaluation is to improve performance. The employees need to be educated to the reality that constant improvement is an expectation, regardless of the level at which employee is currently performing. Advancement and wage increases should be tied to goal accomplishment, not merely survival.

There is an axiom that says "Some employees have ten years of experience. Others have one year of experience ten times." If you expect the top and bottom lines of your business to improve, you need employees who improve as well.

Discussion of past goals and the setting of future goals is the core of the evaluation process. It requires two-way communication and agreement. In the first year it is more difficult, because there's nothing to build on. It gets easier as you go.

Goals need to be SMART (Specific, Measurable, Attainable, Realistic and Timely). Too many review processes get this far and then fail miserably. They have goals like "Chuck needs to take more responsibility for the work flow in the department." How do you decide whether that was accomplished?

Using the SMART approach leads to something like this: "Currently, the data processing department is entering an average of 500 invoices daily, with a 94% accuracy rate. The department objective for the next year is 550 invoices with a 96.5% accuracy. (This might reflect the department supervisor's goals.) In order to advance to a team leader position, Chuck will have to be among the top three employees in his department in both accuracy and processing volume by June 1st of next year."

Setting specific goals will lead to employee feedback on what may be needed to reach them. If Chuck feels that achieving the objective requires additional training, a second computer monitor, or fewer interruptions to answer other departments' questions, this is the time to bring it up.

Note that using behavioral criteria in the scoring section eliminates the need for vague and remedial goals, such as "Chuck needs to show a better attitude." These subjective goals are a major reason for employee dissatisfaction with the process.

There should be at least three goals, and no more than five. Try to couch them in the time frame of the review cycle. Short-term goals lead to fast completion, and an employee who prematurely feels that the next position or raise has been earned.

Summary

There are as many variations to the employee evaluation process as there are companies. Some schedule progress checks on a quarterly basis, others semi-

annually. Some require evaluations to be approved all the way up the management ladder, others have an appeal process.
No matter how small your business is, your employees deserve a system for knowing how well they are doing, and what is expected of them. "We all work together every day" is not an excuse to avoid formal and structured feedback. In fact, the review process will help avoid reactive management driven by day-to-day events.

I used my insight into four or five companies to write this. Each is a leader in its industry when it comes to growth, profitability, employee retention and employee satisfaction. While they will remain anonymous, I can assure you that any business would be thrilled to emulate their results.

Here are their major commonalities:

- A structured, company-wide annual evaluation process
- Reviews are serious and require commitment
- All reviews start with self-evaluations
- Scoring is carefully defined and consistent
- Criteria are widespread and on soft traits, not production
- Goals are SMART, and are commitments by both parties

AUTHOR'S BIO

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Business Ownership Expert

John F. Dini is widely recognized as one of the nation's leading experts on small business ownership. He is a consultant and coach to hundreds of business owners, CEOs and Presidents of companies. John is an outlier in coaching business owners, having achieved the rare feat of delivering over 10,000 hours of face-to-face, personal advice to entrepreneurs.

Mr. Dini is the author of *11 Things You Absolutely Need to Know About Selling Your Business*, now in its second edition. He is a serial entrepreneur currently operating his 9th company, and has conducted business in all 50 United States, Canada, South America, Europe and Asia.

John founded and operates the most successful peer group franchise in North America, overseeing 15 monthly meetings of business owners' groups under the auspices of The Alternative Board®. He holds a Bachelor of Science in Accounting from Rutgers University, a Master of Business Administration from Pepperdine University, is a Certified MBA, and holds six additional certifications in exit planning, business brokerage, behavioral analysis, medical practice management, facilitation and coaching.

Mr. Dini writes numerous articles on business topics for newspapers and magazines, in addition to his weekly column on business ownership on this website Awake at 2 o'clock in the morning? and his opinion blog at Awake at 3 o'clock. He speaks frequently to business groups and national associations, and is a 10-year member of Jim Blasingame's "Braintrust" appearing regularly on "The Small Business Advocate" nationally syndicated radio program as an expert in the issues of business ownership.

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