CHAPTER 3
PERFORMANCE APPRAISAL PARAMETERS

3.1 INTRODUCTION

Performance management is a holistic process bringing together many of the elements which go to make up the successful practice of people management, including in particular learning and development. But for this very reason, it is complex and capable of being misunderstood (CIPD, 2008a).

‘Performance management is not achievable unless there are effective processes of continuous development. This addresses the core competencies of the organisation and the capabilities of individuals and teams. ‘Performance management’ should really be called ‘performance and development management.’ (Armstrong and Baron, 1998)

Performance appraisal is one element of performance management which involves different measurements throughout the organisation. Performance appraisal is the most important if the organisations are to take the advantage of their most important asset, employees, and gain human capital advantage.

3.2 KEY ELEMENTS OF EFFECTIVE PERFORMANCE MANAGEMENT (ARMSTRONG AND WARD, 2005)

The Process by which individual performance is guided, assessed and rewarded is critical because it sends a highly-visible message to people about what is important and valued in the organisation.

People Management and Capability – Armstrong and Ward (2005) advise that organisations must ensure that managers implement performance management systems consistently across the organisation. Managers need to be able to elevate the performance of those around them and their interpersonal skills and behaviour will impact on their ability to do this – (either well or not well). Any training therefore, needs to focus on people management skills and on helping managers to change their behaviour rather than training them to be ‘performance management process’ experts;

Motivation is often a forgotten and rarely-discussed element in the performance management equation, but in keeping with the Purcell (2003) model, the extent to which managers are able to unlock discretionary effort amongst employees is critical in raising
performance levels. Managers need to be advocates of the performance management process, ensuring that objectives are also motivational rather than being purely focused on control and alignment. They also need to be mindful that the quality of the conversations during the process can either motivate or demotivate;

**Measurement and Reward** - the indicators or measures that are used to assess a) individual performance and b) organisational effectiveness can be debilitating if they are not right, leading to confusion, inconsistencies and debates about ratings and rankings rather than optimising the powerfulness of the performance management process as a vehicle for performance improvement through feedback and motivation.

Rather than being regarded as the guardians of the process, the **Role of HR practitioners** should be focused on influencing managers to take charge of the process. Armstrong and Ward (2005) argue that often, too much effort is directed towards compliance issues. Emphasis needs to be placed on those parts of the performance management system - such as the quality of the process - that make the most difference to performance.

**Clarity of purpose and the Role of Culture** within an organisation will affect the extent to which performance management resonates and is congruent with the broader culture of the organisation in which it is being applied. A performance management system that is not delivering often fails because of organisational shortcomings, such as a mismatch between espoused values and incongruent behaviours, or a lack of clarity over direction, priorities or standards. Aligning the performance management process with the direction of the organisation is therefore essential, but it is important to remember that although performance management will support organisational change, it will not be the exclusive or main driver of it (Armstrong and Ward, 2005).

Armstrong and Ward (2005) contend that managers need to understand that “Performance management is not an addition to their day job, it is their day job” and hence they need to focus on achieving results through their teams rather than being task focused. Organisations need to adopt systems and practices that suit their particular strategy and culture. They also recommend that managers who manage people effectively are rewarded and that there are consequences for those who do not.
3.3 PERFORMANCE APPRAISAL

Fombrun et al. (1984) makes explicit use of the word Performance when illustrating the Human Resource Cycle - sometimes referred to as the ELC. This model highlights the importance of performance appraisal as a means of determining rewards and/or the need for further development.

![Figure 3.1: The Human Resource Cycle](Fombrun et al., 1984, cited by Hendry, 1995)

Performance appraisal is “a well-established way of providing milestones, feedback, guidance and monitoring for staff. A further development….is tying this appraisal into a larger and more complex system of performance management” (Weightman, 1999). CIPD (2008d) support the view that whilst performance appraisal is an important part of performance management, it is only one tool amongst a range of tools that can be used to manage performance. They also highlight the fact that because performance appraisals are most usually carried out by the line managers, rather than HR professionals, it is important that they understand their role in the process and have the right skills to conduct them effectively.

Milkovich and Wigdor (1991) purport that whilst performance appraisal aims to accurately assess the effectiveness of an individual’s job performance, as well as improve organisational performance systems, it is impossible to standardise the context within which the appraisal takes place, or indeed the people who are either appraising or
being appraised, further compounding the reasons behind the derision that performance appraisal often receives.

Although the CIPD (2005) purport that there is no one right way to conduct an appraisal, they do advise that there are five key elements to a performance appraisal, underpinned by effective dialogue:

3.3.1 The Five Key Elements of a Performance Appraisal (CIPD, 2008a)

**Measurement:** Assessing performance against agreed targets and objectives.

**Feedback:** Providing information to the individual on their performance and progress.

**Positive Reinforcement:** Emphasising what has been done well and making only constructive criticism about what might be improved.

**Exchange of Views:** A frank exchange of views about what has happened, how appraisees can improve their performance, the support they need from their managers to achieve this and their aspirations for their future career.

**Agreement:** Jointly coming to an understanding by all parties about what needs to be done to improve performance generally and overcome any issues raised in the course of the discussion.

Wolff (2008) asserts that “the key to solving underperformance is communication, communication, communication – coupled with clarity about expectations and objectives, early intervention and ensuring that managers have a clear view of the underlying problem before applying a solution”.

3.3.2 History of Performance Appraisal

There is evidence in the history of performance appraisal that suggests formal performance appraisal began to appear and used in the evaluation of work performance as early as in the 20th century from the time of the First World War initiated by American rather than a British phenomenon (Fletcher and Williams,1992). Initially, in the US, organisation used performance appraisal as a measure to raise morale of the workforce, the assumption being that high morale led to high productivity – a motion reinforced by Hawthorne studies in 1920s.

But the introduction of performance appraisal in the 1920s and 1930s was limited mainly to managers and how to identify those amongst them who had potential for
development. In the 1950s the potential usefulness of appraisal as tool for motivation and development was gradually recognized and the number of companies using performance appraisal programs has risen since then (Fletcher and Williams, 1992).

Hale and Whitlam (2000) claimed that as with many human resource systems, performance appraisal systems evolved out of a perceived requirement to institutionalize and centralize good human resource management practice. The systems were set up in order to aid corporate decision-making, particularly for the purposes of salary review and promotion. The assumption was that line managers concentrated on their line activities and the human resource manager was interested in the people aspects of management. This led to the disempowering of the line manager and the abdication of good people management practices to the human resource department.

In the 1960’s it was realised that a more systematic approach ought to be used and hence the introduction and development of a number of performance appraisal techniques including the popular technique called the management by objectives (MBO). But although very logical in design, the systems were less successful in practice because it was implemented mechanistically and that objectives were imposed on subordinates from above. Critics to MBO argue that the style was judgemental, and feedback would be given without the right to reply. By the end of 1960’s, performance appraisal was generally seen as a more participative, problem solving process concentrated on task performance rather than personality (Fletcher and Williams, 1992).

The following decade saw a number of more specific development and an even greater shift towards openness and participation in appraisal, reflecting changes in society as a whole. Belief about the nature of human abilities, theories of motivation, trade union concerns, government legislation and changing social attitudes have all influenced and modified performance appraisal process (Fletcher and Williams, 1992). During the 1990’s the evident difficulties of assessment and appraisal as isolated activities resulted in growing shift in performance management and the need to link the requirement of business strategy to all employees (Fletcher and William, 1992). Hence the performance measurement system like Balanced Score Card (BSC) introduced by Norton D.P and Kaplan R.S. (1992) come to fore and becoming popular and used by many large organizations globally to measure the overall extensive performance of a company including performance appraisal.
Unlike earlier performance appraisal systems where the application of the systems limited to the managers, there were trends to broaden the application of performance appraisal systems to employees in most job roles, and making performance appraisal much more than a top-down only process. It is commonly accepted that performance appraisal is more effective if an appraisee have more involvement in the review of his own performance (Hale and Whitlam, 2000). Moreover, with the development in upward appraisal, whereby the subordinate actually appraises the performance of the boss, performance appraisal has become even more democratized.

Some observations on the development of performance appraisal practice concluded that the changes that taken place in the field of performance appraisal illustrate the fact that activity in this area reflect wider changes in societies as a whole. As societies have become more open and less rigid, so has performance appraisal. Performance appraisal has developed from becoming the sole concern of top management to being something that the appraisees, the trade unions, the government have a say in (Fletcher and Williams, 1992).

3.3.3 Approaches to Performance Appraisal

There are two approaches to performance appraisal viz. administrative approach and developmental approach.

1. **Administrative approach:** Making and carrying out employment decisions are the fundamental goals of the administrative decision making. Administrative decisions include deciding which employees to promote, which to terminate, which to discipline, which employees to transfer etc. In administrative approach, performance appraisal can be used as a key input for administering a formal organisation reward and punishment system.

   Administrative approach deals with the following:
   - Human resource planning
   - Reward decisions e.g. salary and wages increase
   - Promotions; and
   - Personnel research (e.g. effectiveness of training programmes.)

2. **Developmental approach:** When performance appraisal information is intended to be used for developmental purposes, employees receive concrete feedback
about their job performance. This serves a valuable function because in order to improve in the future, employees need to know what their weaknesses were in the past and how to correct them. This also enables managers to identify which employees would receive the most benefit from developmental inputs. Pointing out strengths and weaknesses is a counseling function for the manager, while receiving meaningful feedback and acting upon it is a motivational experience for the employee. In this way performance appraisal serves as a vehicle for personal development.

Developmental approach deals with the following:
- Provide employee with feedback on their strengths and weaknesses and how to improve future performance.
- Aid career planning and development; and
- Provide inputs for personal remedial interventions.

3.3.4 Pre – requisites of Performance appraisal System:

1. **Documentation** – means continuous noting and documenting the performance. It also helps the evaluators to give a proof and the basis of their ratings

2. **Standards / Goals** – the standards set should be clear, easy to understand, achievable, motivating, time bound and measurable.

3. **Practical and simple format** – The appraisal format should be simple, clear, fair and objective. Long and complicated formats are time consuming, difficult to understand, and do not elicit much useful information.

It is found that, involving performance appraisals often claim adverse impact as a result of the type of rating format used, more specific rating criteria will lead to lessened adverse impact. (H. W. Hennessey Jr., H. John Bernardin, 2003)

4. **Appraisal technique** – An appropriate appraisal technique should be selected; the appraisal system should be performance based and uniform. The criteria for evaluation should be based on observable and measurable characteristics of the behavior of the employee. The appraisal techniques should be easy to administer, implement and economical to undertake.
5. **Diary – Keeping** - The study was designed to examine how structured diary-keeping, and the nature of the appraisal instrument, might be related to affect-appraisal relationships. The study came up with the findings that having raters keep performance diaries actually increased the strength of the relationship between affect and ratings ¹.

6. **Communication** – Communication is an indispensable part of the Performance appraisal process. The desired behavior or the expected results should be communicated to the employees as well as the evaluators. Communication also plays an important role in the review or feedback meeting. Open communication system motivates the employees to actively participate in the appraisal process.

7. **Feedback** – The purpose of the feedback should be developmental rather than judgmental. To maintain its utility, timely feedback should be provided to the employees and the manner of giving feedback should be such that it should have a motivating effect on the employees’ future performance.

8. **Personal Bias** – Appraisal being a complex affair, training should be provided to the appraisers on certain aspects like insights & idea on rating, documenting appraisals, conducting interviews etc. Interpersonal relationships can influence the evaluation and the decisions in the performance appraisal process. Therefore, the evaluators should be trained to carry out the processes of appraisals without personal bias and effectively.

9. **Emphasis on Objectives**: An effective performance appraisal system should emphasis individual objectives, organizational objectives and also mutual objectives. From the viewpoint of individual objective the performance appraisal should talk about

   a) What task the individual is expected to do?

   b) How well the individual has done the task?

   c) How can his performance be further improved?

   d) His reward for doing well.

Failure to appraise the competencies reduces the effectiveness of the competencies and the managerial performance appraisal programs. Hence Appraisal system should
appraise the managerial competencies which in turn help to identify successful employees. (Steven et al. 2001)

3.3.5 Sources of Performance Appraisal:

The appraiser may be any person, who has thorough knowledge about the job content, contents to be appraised, and who observes the employee while performing a job.

1. The immediate supervisor

The general practice is that immediate supervisor appraises the performance of the subordinates. The immediate supervisor is in position to observe, direct and evaluate the subordinate’s performance and is responsible for that person’s performance.

The findings of a case study suggest that Managers who receive positive feedback about their performance subsequently rate the employee significantly higher than managers who receive negative feedback regarding their own performance. This occurs despite the fact that the managers know the evaluation of them is bogus. Hence it can be said that one’s own performance appraisal is related to the subsequent appraisal of one’s subordinates. (Gary P. et al. 2008)

2. Peers

Appraisal by peers is popular in the firms that use team appraisal or peer appraisal. Peers are in a better position to evaluate certain facts of job performance which the subordinates or superiors cannot do. Such facts include contribution to work group projects, interpersonal effectiveness, communication skills, reliability and initiative etc.

This technique of appraisal may be reliable if work group remains stable over a reasonably long period of time and performs the task that requires interaction. Peer appraisals can have impact on open communication, motivation and group viability. Here, an employee chooses an appraisal chairperson every year, that person then selects one supervisor and three-four other peers to evaluate employee’s work.

3. Subordinates

Many organisations let the subordinates to rate their superior’s performance. This process is called as “upward feedback”. It helps in assessing certain aspects of superior’s performance like; management style, ability to communicate, delegate the work, allocate resources and deal with employee on a fair basis etc. It also helps to
know the expectations of the subordinates from their superiors. The rating given by subordinates would also help to identify the competent superiors. Here, the fear or reappraisal often compels a subordinate to be dishonest in his rating.

3. **Self-appraisal**

Self-appraisal gives a chance to the employee to look at his/her strengths and weaknesses, his achievements, and judge his own performance. If employee is clear with the objectives, his/her responsibilities, they are to a great extent in a better position to appraise their own performance.

Employees generally rate their performance more favorably than do their supervisors, which can lead to conflict and poor job performance. However, comparative international research indicates that persons from other-oriented collectivist cultures are less self-enhancing, suggesting that other-oriented employees will exhibit greater agreement with ratings provided by their supervisors. (M. Audrey et al. 2004)

5. **Rating Committees**

Many organisations use rating committees. These committees contain the employee’s immediate supervisor and three or four other supervisors. There can be discrepancy among ratings by individual supervisors, the composite rating tend to be more reliable, fair and valid.

6. **User of Services**

This appraisal is done in service organisations, where performance of an employee is evaluated on certain criteria like promptness, speed in performing a given task, accuracy etc. is judged by users of the service.

7. **Benchmarking:**

Benchmarking is a continuous process of measuring products, services and practices against the recognized competitors with the objective of rectifying performance gaps. Meaningful benchmarking should be between organisations with similar goals and characteristics in order to deliver similar services to their customers. By benchmarking, organisations can identify better performance appraisal procedures and systems and re-design their own evaluation system for increased effectiveness and utility.
3.3.6 What should be rated?

1. **Quality**: The degree to which the process or result of carrying out an activity approaches perfection in terms of either confronting to some ideal way of performing the activity, or fulfilling the activity’s intended purpose.

2. **Quantity**: The amount produced, expressed in monetary terms, number of units, or number completed activity cycles.

3. **Timeliness**: The degree to which an activity is completed or result produced, at the earliest time describe from the standpoints of both co-coordinating with the outputs of others and of maximizing the time available for other activities.

4. **Cost effectiveness**: The degree to which the use of organisation’s resources i.e monetary, human, technological and material etc. is maximized in the sense of getting the highest gain or reduction in loss from each unit.

5. **Need for supervision**: The degree to which a job performer can carry out a job function without either having to request supervisory intervention to prevent an adverse outcome.

6. **Interpersonal impact**: The degree to which a performer promotes feeling of self-esteem, goodwill and co-operation among co-workers and subordinates.

3.3.7 Performance Appraisal Process:

1. **Setting the performance standards**: The first step in the process of performance appraisal is setting up of the standards which will be used as a benchmark to compare actual performance of the employees. This step requires setting the performance criteria to judge performance of the employees as successful or unsuccessful of the degrees. To be useful standards should relate to the desired result of each job. The standards set should be clear, easily understandable and in measurable terms. In case the performance of the employee cannot be measured, great care should be taken to describe the standards.
2. **Communicating the standards:**

There are two parties involved in performance appraisal: appraiser and appraisee. Appraiser is one who does the appraisal and the appraisee is the one whose performance is evaluated.

An appraisee should be informed the standards. This will help them to understand their roles and to know what exactly is expected from them. The standards should also be communicated to the appraisers or the evaluators and if required, the standards can also be modified at this stage itself according to the relevant feedback from the employees or the evaluators.

3. **Measuring the actual performance:**

The most difficult part of the performance appraisal process is measuring actual performance of the employees i.e. the work done by the employees during a specified period of time. It is a continuous process which involves monitoring the performance throughout the year. This stage requires careful selection of the appropriate techniques of measurement such as personal observation, statistical reports, and written reports for measuring the performance.

4. **Comparing actual performance with desired performance:**

At this stage, actual performance is compared with the desired performance or performance standards. Comparison reveals deviations in the performance of the employees from set standards. This comparison can show actual performance being more than the desired performance or, actual performance being less than the desired performance. It includes recalling, evaluating and analysis of data related to the employees’ performance.

5. **Providing feedback:**

Result of the appraisal is communicated and discussed with the employees on one-to-one basis. The focus of this discussion is on communication and listening. The results, problems and possible solutions are discussed, with the aim of problem solving and reaching consensus. The feedback should be given with a positive attitude as this can have an effect on the employees’ future performance. The purpose of a meeting should be to solve the problems faced and motivate the employees to perform better.
6. **Taking corrective action:**

The last step of the process is to take decisions corrective action to overcome the deficiencies or the related HR decisions like rewards, promotions, demotions, transfers etc.

**3.3.8 Traditional Methods of Performance Appraisal**

1. **Essay Appraisal Method:**

In essay appraisal, appraiser rates the employee in an open-ended manner and put down his impressions about the employee on a continuous basis. These impressions relate to strong and weak points of the employee’s behaviour. He takes note of these factors:

- Job knowledge and skills exhibited by the appraisee while performing his job
- Appraisee’s relationship with the employees and manager
- Appraisee’s personality traits and attitude towards his job, peers, manager and the organisation.
- Appraisee’s understanding and commitment to organization’s goals and objectives and
- Appraisee’s potential for organisational future roles.

It is the simplest evaluating method in which evaluator writes an explanation about employee’s strength and weakness points, previous performance, positional and suggestions for his (her) performance improvement at the end of evaluation term. This kind of evaluations usually includes some parts of other systems to cause their flexibility. This method often combines with other methods. In essay appraisal, we attempt to focus on behaviors (Mondy, 2008).

2. **Grading:**

In this technique, the rater considers certain features and marks them according to a scale. The selected features may be analytical ability, cooperativeness, dependability, self-expression, job knowledge, leadership and organizing ability. These may be graded as e.g. A-Outstanding, B-Very good, C- Average, D-Fair, E-Poor and F-Very poor. The actual performance of an employee is then compared with these grades and he is allotted the grade which best describes his performance.
3. **Ranking Method:**

Under this method, superior ranks his subordinates in order of their merit, starting from the best to the worst. The relative position of each employee is expressed in terms of his numerical rank. In this type of appraisal, individuals are ranked from highest to lowest. It is assumed that the difference between the first and second employee is equal to difference between 21\textsuperscript{st} and 22\textsuperscript{nd} employee. In this method, the manager compares each person with others than work standards (Dessler, 2000).

4. **Checklist Method:**

In this method, the evaluator has a list of situations and statements and compares it with employees. The checklist is a presentation of employee’s characteristics and performance. The results can be quantitative and give weight to characteristics. A typical checklist is given in the table below. After ticking off against each item, rater forwards the list to HR department. The HR department assigns certain points to each ‘Yes’ ticked. When points are allotted to the checklist, technique becomes a *weighted checklist*. The advantages of as checklist are economy, ease of administration, limited training of rater, and standardization. The disadvantages include susceptibility to rater’s biases (especially the halo effect), use of personality criteria instead of performance criteria, misinterpretation of checklist items, and the use of improper weights by the HR department. Another disadvantage of this approach is that it does not allow the rater to give up relative ratings.

5. **Rating Scales:**

This is the simplest and the most popular technique for appraising employee performance; the typical rating-scale system consists of several numerical scales, each representing a job-related performance criterion such as dependability, initiative, output, attendance, attitude, co-operation, and the like. Each scale ranges from excellent to poor. The rater checks the appropriate performance level on each criterion, and then computes the employee’s total numerical score. The number of points scored may be linked to salary increases, whereby so many points equal a rise of some percentage. Rating scales offer the advantages of adaptability, relatively easy use and low cost. Nearly every type of job can be evaluated in a short time, and rater does not need any training to use the scale. The disadvantages of this method are several. The rater’s biases are likely to influence evaluation, and the biases are particularly pronounced on...
subjective criteria such as cooperation, attitude and initiative. Furthermore, numerical scoring gives an illusion of precision that is really unfounded.

1. **Critical Incident Method:**

It focuses on key factors which make difference in performing a job efficiently. This method is more credible because it is more related to job and based on individual’s performance than characteristic. The necessity of this system is to try to measure individuals’ performance in term of incidents and special episodes which take place in job performance. These incidents are known as critical incident. In this method, the manager writes down the positive and negative individuals’ performance behavior in evaluation term (Mondy, 2008).

The critical incidents method of employee assessment has generated a lot of interest these days. The approach focuses on certain critical behaviors of an employee that make all the difference between effective and non-effective performance of a job. The supervisors record such incidents as and when they occur.

The method has significant limitations.

These include:

1. Negative incidents are generally more noticeable than positive ones.
2. The recording of incidents is a chore to the supervisor and may be put off an easily forgotten.
3. Overly close supervision may result.
4. Managers may unload a series of complaints about incidents during an annual performance review session. The feedback may be too much at one time and thus appearing as a punishment to the rate. More appropriately, the management should use incidents of poor performance as opportunities for immediate training and counselling.

The essence of this technique is that it attempts to measure employee’s performance in terms of certain events or episodes that occur in the performance of the job. These events are known as critical incidents. The superior keeps a log of positive and negative examples (incidents) of subordinate’s work related behaviour. The basis of this method is the principle that there are certain significant acts in each employee’s behaviours and performance, which make all the difference between success and failure in the job.
7.  **Behaviourally anchored rating scale:**

This method is a combination of the rating scale and critical incident techniques of performance appraisal. It is a tool that anchors a numerical rating scale with specific behavioural examples of good or poor performance.

Behaviorally Anchored Scales, sometimes called behavioral expectation scales, are rating scales whose scale points are determined by statements of effective and ineffective behaviors. They are said to be behaviorally anchored in that the scales represent a range of descriptive statements of behavior varying from the least to the most effective. A rater must indicate which behavior on each scale best describes an employee’s performance.

Behaviorally anchored rating scales (BARS) have the following features:

1. Areas of performance to be evaluated are identified and defined by people who will use the scales.
2. The scales are anchored by descriptions of actual job behavior that, supervisors agree, represent specific levels of performance. The result is a set of rating scales in which both dimensions and anchors are precisely defined.
3. All dimensions of performance to be evaluated are based on observable behaviors and are relevant to the job being evaluated since BARS are tailor-made for the job.
4. Since the raters who will actually use the scales are actively involved in the development process. They are more likely to be committed to the final product. BARS were developed to provide results which subordinates could use to improve performance. Superiors would feel comfortable to give feedback to the rates. Further, BARS help overcome rating errors. Unfortunately, this method too suffers from distortion inherent in most rating techniques.

BARS have five stages (Decenzo, 2002):

1) Generate Critical Incidents
2) Develop performance dimensions,
3) Relocate incidents,
4) Rating of level of performance for each incident and
5) Development of the final instrument.
8. **Forced Choice Method:**

In this, the rater is given a series of statements about an employee. These statements are arranged in blocks of 2 or more, and the rater indicates which statement is most or least descriptive of the employee. Typical statements are:

1. Learns fast _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ works hard
2. Work is reliable _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ performance is a good example for
3. Absents often _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ others usually tardy.

As in the checklist method, the rater is simply expected to select the statements that describe the rate. Actual assessment is done by the HR Department. This approach is known as the forced choice method because the rater is forced to select statements, which are readymade. The advantage of this method is the absence of personal bias in rating. The disadvantage is that the statements may not be properly framed – they may not be precisely descriptive of the ratee’s traits.

9. **Paired Comparison Method:**

In this method, the appraiser compares each employee with all others in a group one at a time. After all the comparisons, on the basis of the overall comparisons, the employees are given the final rankings.

Under this method the appraiser compares each employee with every other employee one at a time. For example there are five employees named A, B, C, D and E. The performance of A is first compared with the performance of B and a decision is made about whose performance is better. Then A is compared with C, D and E in that order. The same procedure is repeated for other employees. The number of comparisons may be calculated with the help of a formula which reads thus: \( N (N-1)/2 \) where N stands for the number of employees to be compared. If there are 10 employees, the number of comparisons will be \( 10(10-1)/2 = 45 \).

After the completion of comparison, the results can be tabulated and a rank is created from the number of times each person is considered to be superior.

10. **Confidential Report:**

It is mostly used in government departments. This report is prepared at the end of a year. It shall have certain items like attendance, leadership, initiative, ability to work with others, job knowledge, integrity etc. The superior records his impression about the
subordinate considering these items. This system does not offer any feedback to the subordinates hence there is no surety of why he/she is rated low than the others.

3.3.9 Modern Methods of Performance Appraisal

1. Assessment Centre:

An assessment centre typically involves the use of methods like social/informal events, tests and exercises, assignments being given to a group of employees to assess their competencies to take higher responsibilities in the future. Generally, employees are given an assignment similar to the job they would be expected to perform if promoted. This review of potential is concerned with forecasting the direction in which an individual’s career should go and the rate at which he is expected to develop.

The trained evaluators observe and evaluate employees as they perform the assigned jobs and are evaluated on job related characteristics. The major competencies that are judged in assessment centres are interpersonal skills, intellectual capability, planning and organizing capabilities, motivation, career orientation etc. assessment centres are also an effective way to determine the training and development needs of the targeted employees.

2. Management by Objectives:

MBO (or management by objectives) is a technique credited to management guru Peter Drucker, to describe a method of performance management that is based on the setting of clear and measurable objectives, and the use of those objectives to evaluate and review performance. When done correctly, MBO is probably the best and fairest way to plan for and create effectively performing employees.

The principle behind Management by Objectives (MBO) is to make sure that everybody within the organization has a clear understanding of the aims, or objectives, of that organization, as well as awareness of their own roles and responsibilities in achieving those aims. The complete MBO system is to get managers and empowered employees acting to implement and achieve their plans, which automatically achieve those of the organization.
MBO Strategy: Three basic parts

- All individuals within an organization are assigned a special set of objectives that they try to reach during a normal operating period. These objectives are mutually set and agreed upon by individuals and their managers.
- Performance reviews are conducted periodically to determine how close individuals are to attaining their objectives.
- Rewards are given to individuals on the basis of how close they come to reaching their goals.

MBO as a goal setting and appraisal programme consists of six steps:

1. **Setting organisational goals**: Based on firm’s strategic plan establish organisational plan for next year, and from this set company’s goals.
2. **Set departmental goals**: Departmental heads take these company goals and with their superiors jointly set goals for their departments.
3. **Discuss departmental goals**: Departmental heads discuss departmental goals with their subordinates. They ask the subordinates to set their individual goals.
4. **Define expected results**: Departmental heads and their subordinates set short term individual performance targets.
5. **Performance reviews**: Departmental heads compare each employee’s actual and targeted performance.
6. **Provide feedback**: Departmental heads and employee discuss and evaluate the latters’ progress

3. **Human Resource Accounting Method**:

Human resources are valuable assets for every organization. Human resource accounting method tries to find the relative worth of these assets in the terms of money. In this method the performance appraisal of the employees is judged in terms of cost and contribution of the employees. The cost of employees include all the expenses incurred on them like their compensation, recruitment and selection costs, induction and training costs etc whereas their contribution includes the total value added (in monetary terms). The difference between the cost and the contribution will be the performance of
the employees. Ideally, the contribution of the employees should be greater than the cost incurred on them.

4. **360 degree Feedback:**

360 degree feedback is also known as ‘multi-source feedback. First developed at General Electric, US in 1992, the system has become popular in our country too. GE (India), Reliance Industries, Crompton Greaves, Wipro, Infosys, Thermax are using this method with great benefits. 360 degree Feedback is systematic collection of performance data on an individual or group from a number of sources. The sources are immediate supervisors, peers, customers, self. Having collected data from these sources 360 degree feedback provides broader perspective about employee performance. The 360-degree evaluation can help one person be rated from different sides, different people which can give the wider prospective of the employee’s competencies (Shrestha, 2007). It has been used for human resource development, appraisal and pay decisions (Stone, 2002).

In the past few years, few human resource practices have received as much attention as multi-source feedback systems (MSFSs). In the US and Canada, it is estimated that over one-third of organizations are using some form of MSFS and recent surveys show that this practice is still gaining popularity.

The results of an international survey of MSFS, the data collected from HR managers and consultants from Argentina, Australia, China, Slovakia, Spain and the UK demonstrate that MSFS are being implemented, in slightly different ways, in each of these six countries. The main challenges in the application of MSFS in these various countries are the communication efforts necessary before and after implementation, and the inherent difficulty in giving and receiving feedback.

5. **Computerized and Web based performance appraisal:**

Nowadays, several performance appraisal software programmes are available. These software programmes enable managers to keep computerized notes on subordinates during the year, and then to combine these with ratings of employees on several performance traits. The software programmes then generate written text to support each part of the appraisal. In the traditional Appraisal system, the paper based appraisal causes a lot of manual work, which is time consuming, not secure and difficult to
analyse the performance. Whereas Web based performance appraisal provides an easy way to conduct appraisal.

6. Psychological Appraisals
Large organization employs full-time industrial psychologists. These psychologists are used for evaluations. They assess an individual’s future potential and past performance. The appraisal normally consists of in-depth interviews, psychological tests, discussions with supervisors and a review of other evaluations. The psychologists then write an evaluation of the employee’s intellectual, emotional, motivational and other-related characteristics that suggest individual potential and may predict future performance. The evaluation by the psychologist may be for a specific job opening for which the person is being considered. Or it may be a global assessment of his or her future potential. From these evaluations, placement and development decisions may be made to shape the person’s career.

3.3.10 Problems with Performance Appraisal:

1. Leniency Error:
Typically some raters have a tendency to avoid conflict with their employees and project themselves as ‘good managers’. In an effort to avoid conflict, the rater has the tendency to be overly generous in judgement. They assign higher rating to an employee’s performance than warranted by his actual level of performance.

2. Strictness Error:
Strictness error refers to the tendency of raters to be overly harsh while judging performance of employees. This may be a case where the standards of performance may be too high or unrealistic or the manager’s personality characteristics or experience may be the cause. Such strictness results in lower rating of all employees under the rater and cause frustration and anger in good performers. Leniency or severity on the part of a rater defeats the very purpose of performance appraisal. Depending on rater’s own mental make up at the time of appraisal, rater may rate strictly or leniently. Holding raters accountable for the accuracy of their ratings, especially when ratings are for administrative purposes, may be an effective strategy for reducing leniency error. (Ami B. et al. 2005)
2. **Spill over Effect:**

A spillover effect takes place when past performance appraisal ratings unjustifiably influence current ratings. Past ratings, good or bad, result in similar rating for current appraisal although demonstrative behavior does not deserve the ratings, good or bad.

4. **Bias Effect:**

This effect to allow individual differences such as sex, race, and age to affect the appraisal ratings employee receive.

The interpersonal affect, a like-dislike relationship between a supervisor and his/her subordinate, has traditionally been conceptualized as a source of bias in performance appraisals. However, some researchers have argued that the interpersonal affect may not be a bias, especially where it develops as a result of past performance.

5. **Halo Effect:**

In halo effect, the appraiser / manager draws on one specific characteristics/accomplishment to excessively influence performance review or applies favourable ratings to all job duties based on impressive performance in one area. For example, if an employee is accurate in work but lacks initiative

This error takes place when one aspect of an individual’s performance affects the appraisal of his entire performance. In an organisation halo error occurs when an employee who works late constantly might be rated high on productivity and quality of output as well as on motivation.

6. **Horn Effect:**

Highly critical bosses have tendency to compare performance of their subordinates with negative attitude.

6. **Rater Effect:**

High or low ratings are given to certain individuals or groups based on rater’s attitude towards the ratee not on actual performance or output. This includes stereotyping, favouritism and hostility.

Recent performance appraisal research has highlighted the important role played by contextual and individual factors in shaping rating behavior such as personality factors
or beliefs, systematically affect rating behavior. The effects of these context and rater factors are reflected in ratings accuracy, ratings discrimination among raters/dimensions, and rating elevation. (Aharon Tziner et al. 2005)

According to the findings of a study attitudes and beliefs account for substantial variance in rater’s likelihood of giving high or low ratings, willingness to discriminate good from poor performers, and willingness to discriminate among various aspects of job performance when completing actual performance ratings. (Aharon Tziner et al. 2001)

7. **Status Effect:**

The employees working at higher level jobs are overrated whereas employees working at lower level jobs underrated.

8. **Latest behaviour:**

Sometimes, the appraisal is influenced by the most recent behaviour, ignoring the common behaviour of an individual during the entire period.

9. **Shifting Standards:**

Performance appraisal should be based on uniform and fair standards. If the standards are changed then employees might get confused and organisation might not be able to promote right candidate. For e.g. last year quality was the criteria for appraisal but boss decides to judge them this year on the basis of quantity.

10. **First impression:**

Raters may form an overall impression of a candidate based on some specific qualities or behaviour in first meeting and carry it forward. At the time of appraisal rater rates a candidate with same impression.

11. **Poor appraisal forms:**

The appraisal process might also be influenced by certain factors relating to appraisal forms such as vague and unclear rating scale, irrelevant performance dimension, long and complex contents in the form etc.
12. **Situational factors:**

Theory and research suggest that both person and situation influence observed performance. System or situational factors can either enhance or constrain performance. If raters do not compensate for the influence of situational factors, ratings will be contaminated with situational influences and will fail to validly reflect the true level of performance (I.M. Jawahar, 2005).

13. **Political Purposes:**

There is evidence that performance ratings are often manipulated for political purposes. The study examined the effects of employees’ perceptions of political motives in performance appraisal on their job satisfaction and intention to quit. Results indicated that when employees perceived performance ratings to be manipulated because of raters’ personal bias and intent to punish subordinates, they expressed reduced job satisfaction that, in turn, led to greater intentions to quit their jobs. Manipulations of ratings for motivational purposes, however, had no effect on job satisfaction and turnover intention. (June M.L. Poon, 2004)

3.3.11 **Developing Performance Appraisal System:**

A formal performance appraisal system can provide a framework within which appraisers and appraisees can operate. A performance appraisal system can be developed through a programme comprising the following stages:

1. **Determine overall approach to performance appraisal.** The decisions on the overall approach to introduce performance appraisal should cover the following:
   
   (i) What are the objectives of introducing performance appraisal?
   (ii) What benefits are anticipated from introducing performance appraisal?
   (iii) What are the main features of the approach to performance appraisal?

2. **Where and how should PA be introduced?** Performance appraisal is best introduced on an organization-wide basis starting at the top. The most common and best method is to set up a project team or working group for this purpose.

3. **Decide who is to be covered?** At one time most schemes were restricted to managers but performance appraisal is now being extended to all the members of
professional, administrative, technical and support staff. The decision as to who is to be covered should be made at the outset itself.

4. **Decide on whether the same approach should be adopted at each level.** In most cases, the essence of the approach is the same for all levels, though performance measures vary for different levels.

5. **Set up project team.** Project teams, consisting of managers and other employees and a member of the human resources department and/or an outside consultant are a valuable means of getting involvement and ownership.

6. **Define role of human resource department.** The role of human resource department in developing and implementing performance appraisal system is to convince top management that its introduction will make a significant impact on the organizational performance.

7. **Decide whether to use outside consultants.** External consultants can be used to advice on and facilitate the introduction of performance appraisal to run training programmes and, to carry on evaluation studies including the conduct of attitude surveys. But as they are costly, care must be taken in selecting consultants who have the required level of experience and expertise.

8. **Define performance management processes and documentation.** The project team needs to pay attention to each point against a background of an understanding of the objectives to be attained and the culture and structure of the organization. Particular attention needs to be given to the development of rating plans and document design. When designing performance appraisal forms, the aim should be to keep them as simple and brief as possible while allowing ample ‘white space’ for comments. It is desirable to issue an overall description of performance appraisal system to all concerned which sets out its objectives and methods of operation and the benefits it is expected to provide for the organization and its employees.

9. **Pilot test:** The whole PA system cannot be pilot tested because the cycle lasts generally for 12 months. Some aspects of performance appraisal like drawing up performance agreements, objective setting, document completion, etc. can however be pilot tested. Based on the experience gained, the system may be fine-tuned.
10. **Plan implementation programme:** The implementation programme should cover the following:

(i) Date of introducing performance appraisal in the whole or different parts of the organization (phased as necessary)
(ii) Procedure for evaluating the process
(iii) Briefing/training programme

An empirical study was conducted based on the effectiveness of the performance management systems in selected Indian companies. As part of the study, antecedents and consequences of effective implementers of performance management systems in the Indian context were also examined. It was found that managers having good academic backgrounds with high profiles are effective implementers of the system. Further, it was found that personality characteristics/consequences such as system discipline, exposure to the system, effective interpersonal relations and team working are essentially required for the effective implementation of the system.

### 3.3.12 Concerns and Issues in Performance Appraisal:

Performance Appraisal is a long-term feature of human society and is an often debatable human resource activity. There are those who want to do away with it, and those who view it as necessary. Due to the differences of opinion, various issues arise in performance appraisal system.

Some of the common Concerns and Issues in Performance Appraisal:

- Undertaking job analysis for designing job descriptions and job specifications for different positions in the organisation;
- Deciding on appraisers, communication strategy, interview agenda, and utilization of appraisal data for employee development and organisational growth;
- Identifying performance objectives for each and every job;
- Deciding the standards of performance
- Prioritization of performance objectives in terms of measurable outcomes and emphasizing key success factors;
- Determining appropriate methods for appraising employee performance;
- Establishing procedure for appraising performance that is accepted by all stakeholders (shareholders, CEO, managers, employees and HR department), transparent and fair;
- Providing constructive and non-judgmental feedback on employee performance including negative feedback;
- Linking rewards to clearly observed and measured performance of employees;
- Providing appeals procedure for employees to air their concerns and grievances on performance appraisal;
- Training managers and employees on appraisal systems; and
- Auditing appraisal systems for ensuring its effectiveness and taking remedial actions for improvement.

3.3.13 Characteristics of an Effective Performance Appraisal System

According to Watson and Wyatt Survey (2002), “organisations need strategic support of employees in new economy. People are more important than ever, people are the only sustainable source of competitive advantage”. Thus, performance appraisal assumes significance for every business organisation. A good appraisal system possesses the following characteristics:

- It is based on evidence
- It is highly individualized
- It is a joint activity
- It strives for understanding.
- It creates commitment
- It maximizes self-analysis and self-discovery
- It results in improved performance

The essential characteristics of an effective performance appraisal system are as follows:

1. **Simple rating system**: The rating system should be simple and based on job analysis for ensuring accuracy and fairness of performance evaluation of employees.
2. **Training in appraisal system:** All employees, including managers, should be trained to use the appraisal system so that they understand the objectives, methodology and purpose of performance appraisal.

3. **Quantifying performance:** Performance appraisal should be based on accurate up-to-date job descriptions and ratings be made on observable performance.

4. **Freedom from biases:** Evaluations should be done under standard conditions and should be free from adverse impact arising due to personal biases and gender discrimination. A biased appraisal system is worse than having no appraisal system as it damages the motivation, morale and productivity of employees and impairs performance oriented behaviour.

5. **Participative:** Preliminary results of performance appraisal should be shared with the employee to develop confidence of employees in the system and to provide opportunities for discussions.

6. **Reviewing officer:** There must be some upper level reviews with appeal provision so that appraisal ratings are normalized and employees have an opportunity to speak against unfair treatment by their immediate superiors.

7. **Performance feedback:** Performance counselling and feedback should be provided to employees for creating joint action plans for rectifying deficiencies in performance and seeking means and measures for improving performance in future.

8. **Combining absolute and relative standards:** Appraisal should be carried out by combining absolute and relative performance standards so that job performance expectations are relative and achievable.

9. **Using behavior based measures:** Behavioural based measures should be used to correct and develop appropriate employee attitudes, motivation and behavior for directing and controlling employee efforts and outcomes.

10. **Identification of performance goals:** Performance appraisal of employees should also be based upon agreed performance goals and targets for ensuring that employees are rated for the level of performance expected from them.

11. **Training & Development:** Performance should be used for employee development purposes so that gaps in skills and competencies are addressed and removed for better performance and productivity.
12. **Recognize and reward achievement**: Appraisals should recognize, reward, reinforce and publicize employee achievements to motivate and serve as a role model for others to emulate.

13. **Identifying improvement areas**: Appraisal should identify areas where performance is good and when it can be improved.

14. **Confidence and acceptability of employees**: Performance appraisal process should be carried out in such a way that employees response trust and confidence in the system. Without employee acceptance, performance appraisal shall serve no organisational purposes and will get reduced to a mere ritual on paper.

15. **Documentation**: Appraisal process should ensure that performance goals and specific activities for developing performance of employees are documented for further reference and as legal backup.

### 3.3.14 Appraising Potential for Performance Enhancement

Performance appraisal helps in appraising potential of employees. Appraisal of potential is the evaluation of an individual’s capability for growing into large responsibilities. Every employee wants to sharpen his existing skills and develop new ones. Potential appraisal aims to identify opportunities within the organisation and to assess the capability of individuals to qualify for them.

Potential appraisal aims to:

1. Inform employees of their future prospects in the organisation.
2. Facilitate succession planning for key leadership roles.
3. Reviewing recruitment, selection, socialization, training and mobility activities.
4. Guide employees to career paths available within the organisation.

Potential appraisal is a systematic process of realizing the full capacity of an individual for exhibiting excellent performance. It involves the following steps:

1. **Determine organisational needs and requirements**: Organisations need to determine various career growth opportunities available in the organisation both within the existing resources and future manpower needs keeping in growth and expansion plans of the organisation. Therefore, planning for career development, succession plans, restructuring, re-assignment and other pertinent factors should
be determined so that employee potential is harnessed and utilized to mutual advantage of employees and the organisation.

2. **Assess employee expectations:** Individuals tend to grow to fill the mental picture they have of themselves. It is important to help them make the mental picture full and challenging. It is also important to find out what the employees want, because this is the sound indicator of what they will do. One person may be eager to qualify top management post; another with similar qualifications and ability may not want to make the effort or may not want the added responsibility and the stresses that come with it.

3. **Determine job specifications:** Individuals qualify for specific jobs and, if they wish to be considered for them, they must have the education, experience and other qualifications needed. For this reason, specifications for each position should be readily available. Often these will be the same job specifications as are used in selecting people for these positions can be made available for review to individuals who want to build their skills and abilities so they can be ready for opportunities when they come up.

4. **Identify developmental opportunities:** Often there are gaps between position requirements and the qualifications of individuals who want to be considered for jobs as they come open. Employees who are interested should be helped to appraise their own strengths and weaknesses and to identify gaps in experience, education or training. These assessments will be of greatest value in the counseling processes that follow. Generally, it is best to put these career path assessments in writing, which can be used as a basis for career counseling.

3.3.15 Reasons for failures of performance appraisals:

1. **Linking employee’s performance to organisational goals and objectives:** For effectiveness of a performance appraisal system, aligning employee’s performance with organisational goals and objectives is of paramount importance. However, in most of the organisations, a clear linkage between employee’s performance objectives and business strategy is often a missing element. This is because many times leaders are not clear how to establish performance metrics and indicators for eliciting employee performance. It generally bogs down to the common measure practiced in the industry without understanding the business
strategy, resources and competencies of every organisation are unique. In the absence of clear understanding of what to measure, employee’s performance gets reduced to a paper exercise to point out his strengths and weaknesses only.

2. **Linkage to compensation:** Performance appraisal system is the prime basis of compensation related decisions of employees. Many organisations clearly link compensation to performance as a means of improving individual contributions. Whenever money gets involved, the value of meaningful performance gets backseat. Employees and managers get overwhelmed with compensation raises and issues which prevent measurement and development of performance, which is invariably the objective of performance appraisal system. Due to strong financial connotations of performance appraisal system, it lacks focus on performance.

3. **High dependence on HR department:** HR department is hailed as the custodian of performance appraisal system. However the truth is that the true custodian is the line managers and CEO because the system is about improving performance of all employees(not just HR head) and ultimately the whole organisation (not just the HR department) in order to ensure continued competitiveness of the organisation. But due to wide spread misconception, it is considered to be a HR department’s instrument only.

4. **Measuring managerial performance vis-à-vis employees:** Performance appraisal system is about planning, measuring and developing performance of all employees including CEO, managers and their subordinates. Some managers believe that appraisal system is all about employee performance only. The result is that manager’s performance is not measured against their subordinate’s performance. Organisational performance will improve when managers and employees are together part of this improvement process.

5. **Sensitivity to organisational culture:** Performance appraisal system being a human judgement and enabled process / system, organisational cultures play an important role. Culture holds people together through shared values, attitudes and perceptions. Unless, the system is not in conjunction with the culture of the organisation, it can never be instituted in the organisation. Without institutionalization of the system, performance appraisal process tends to be transactional in nature without adding value to the organisation. This is the reason
that the system is successful in some organisations, carried over in some other and scrapped in still some more.

6. **Return on Investment:** Performance appraisal system entails individual and organisational investment in terms of time and efforts; therefore return on investment needs to be measured. Often organisations emphasize measuring return on investment on training but seldom do they focus on getting returns on their most important mechanism that is performance appraisal system. Incomplete data gathering and using limited criteria can create a false image. The reason behind is that it is considered to be a transactional operation implemented for the purpose of deciding employee compensation, identifying training programmes and awarding promotions, transfers and terminations. It has unfortunately got reduced to administrative machinery than a business system.

3.3.16 **Challenges of Performance Appraisal System:**

In order to make a performance appraisal system effective and successful, an organization comes across various challenges and problems. The main challenges involved in the performance appraisal process are:

1. **Determining the evaluation criteria:**
   Identification of the appraisal criteria is one of the biggest problems faced by the top management. The performance data to be considered for evaluation should be carefully selected. For the purpose of evaluation, the criteria selected should be in quantifiable or measurable terms.

2. **Creating rating instruments:**
   The purpose of the performance appraisal process is to judge the performance of the employees rather than the employee. The focus of the system should be on the development of the employees of the organization.

3. **Lack of Competence:**
   Top management should choose the raters or the evaluators carefully. They should have the required expertise and the knowledge to decide the criteria accurately. They should have the experience and the necessary training to carry out the appraisal process objectively.
4. **Errors in rating and evaluation:**
   Many errors based on the personal bias like stereotyping, halo effect (i.e. one trait influencing the evaluator’s rating for all other traits) etc. may creep in the appraisal process. Therefore the rater should exercise objectivity and fairness in evaluating and rating the performance of the employees.

5. **Resistance:**
   The appraisal process may face resistance from the employees and the trade unions for the fear of negative ratings. Therefore, the employees should be communicated and clearly explained the purpose as well the process of appraisal. The standards should be clearly communicated and every employee should be made aware that what exactly is expected from him/her.

**Other challenges of Performance Appraisal:**

1. Create a culture of excellence that inspires every employee to improve and lend him or herself to be assessed.
2. Aligns organisational objectives to individual aspirations.
3. Clear growth paths for talented individuals.
4. Provide new challenges to rejuvenate careers that have reached the plateau stage.
5. Forge a partnership with people for managing their careers.
6. Empower employees to make decisions without the fear of failing.
7. Embed teamwork in all operational processes.
8. Debureaucratise the organisation structure for ease of flow of information.

**3.4.17 Current global trends in Performance Appraisal:**

The performance appraisal process has become the heart of the human resource management system in the organisations. Performance appraisal defines and measures the performance of the employees and the organisation as a whole. It is a tool for accessing the performance of the organisation.

**The important issues and points concerning performance appraisal in the present world are:**

- The focus of the performance appraisals is turning towards career development relying on the dialogues and discussions with the superiors.
Performance measuring, rating and review systems have become more detailed, structured and person specific than before.

Performance related pay is being incorporated in the strategies used by the organisations.

Trend towards a 360-degree feedback system

The problems in the implementation of the performance appraisal processes are being anticipated and efforts are being made to overcome them.

In India, the performance appraisal processes are faced with a lot of obstacles, the most prominent being the lack of quantifiable indicators of the performance.

3.4 ASSESSMENT OF ORGANISATIONAL PERFORMANCE:

Organisations measure their performance for numerous reasons. Some of them are as below:

1. **Improvement**: By tracking performance, companies can spot and promptly address problems such as declining customer loyalty, flattening profits, or defections of talented employees.

2. **Planning and forecasting**: Performance measurement serves as progress check, enabling organisations to determine whether they are meeting their goals and whether they need to revise their budgets and forecasts.

3. **Competition**: When companies compare their performance against their rivals and against industry benchmarks, they can identify weak areas and address them to sharpen their competitive edge.

4. **Regulatory and standards compliance**: Many companies measure performance in order to comply with government regulations (such as antipollution laws) or international standards (for instance, ISO 9000).

3.5 WHAT IS PERFORMANCE MEASUREMENT?

Measuring performance means assessing business results to:

(1) determine the effectiveness of its operating processes, and

(2) make changes to address shortfalls and the other problems.

Companies take stock of their performance using different methods and criteria. However, in many organisations, performance measurement entails examining the
results generated by key business activities, using specific performance metrics (also known as measures).

Many organisations use a coordinated system, or framework, to appraise business performance across their functions. The best performance measurement systems demonstrate balance:

1. They assess company’s financial performance (such as revenues, expenses, and profits) and non-financial performance (employee knowledge, information systems availability, quality of customer relationships.)

2. They draw on internal data (such as process quality) and external data (for example, third party rankings of companies product performance against competitors)

3. They examine lagging indicators and leading indicators.

4. They weigh subjective (difficult to quantify) aspects of performance (such as customer satisfaction and employee capabilities) and aspects (for example, revenues and return on invested capital).

3.6 KEY PERFORMANCE INDICATORS (KPIS)

A Key performance indicator (KPI) is a measure reflecting how an organisation is doing in specific aspect of performance. A KPI is one representation of a critical success factor (CSF) - A key activity needed to achieve strategic objective. Organisations that measure performance identify the handful of critical success factors that comprise every strategic objective. For example, depending on a company’s strategy, the organisation might have a KPI for the percentage of income the organisation derives from international markets.

Key financial performance indicators are:

- **Return on Investment (ROI) / Return on Total Assets (ROTA):** ROI represents the benefits generated from the use of assets in a company, unit, or group – or on a project.

  \[
  \text{ROI} = \frac{\text{Net Income}}{\text{Total Assets}}
  \]
- **Economic Value Added (EVA):** EVA is defined as the value of business activity that is left over after subtracting from it the cost of executing that activity and the cost of the physical and financial capital deployed to generate the profits.

\[ \text{EVA} = \text{Net operating profit after taxes} - (\text{net operating assets} \times \text{weighted average cost of capital}) \]

Apart from these key financial indicators, company’s financial performance can be computed on the basis of following profitability ratios:

1. Margin on Sales percentage = \( \frac{\text{Earning before Interest and Tax \%}}{\text{Sales}} \)
2. Sales to total assets = \( \frac{\text{Sales}}{\text{Total Assets}} \)

Customer profitability (i.e. Customer count, customer retention) is the important performance metric also reveals the organisational performance.

### 3.7.1 MODERN TECHNIQUES OF PERFORMANCE MEASUREMENT:

#### 3.7.1 Balanced Scorecard

The balanced scorecard is a strategic planning and management system that is used extensively in business and industry, government, and non-profit organizations worldwide to align business activities to the vision and strategy of the organization, improve internal and external communications, and monitor organization performance against strategic goals. It was originated by Dr Robert Kaplan (Harvard Business School) and Dr David Norton as a performance measurement framework that added strategic non-financial performance measures to traditional financial metrics to give managers and executives a more ’balanced’ view of organizational performance. While the phrase balanced scorecard was coined in the early 1990s, the roots of the this type of approach are deep, and include the pioneering work of General Electric on performance measurement reporting in the 1950’s and the work of French process engineers (who created the *Tableau de Bord* – literally, a ”dashboard” of performance measures) in the early part of the 20th century.
Balanced Scorecard Perspectives:

The balanced scorecard suggests that we view the organization from four perspectives, and to develop metrics, collect data and analyze it relative to each of these perspectives:

1. **Financial Perspective:** examines if the company’s implementation and execution of its strategy are contributing to the bottom-line improvement of the company. Some of the most common financial measures that are incorporated in the financial perspective are revenue, profit margins, net operating income, return on capital employed, and economic value added etc.

2. **Customer Perspective:** defines the value proposition that the organisation will apply in order to satisfy customers and thus generate more sales to the most desired (i.e the most profitable) customer groups. The measures that it includes such as customer retention, customer satisfaction and market share in target segments.

3. **Business Process Perspective:** is concerned with the processes that create and deliver the customer value proposition. It focuses on all the activities and key processes required in order for the company to excel at providing the value
expected by the customer both productively and efficiently. It includes measures such as cost, throughput, and quality. These are for business processes such as procurement, production and order fulfillment.

4. **Learning and Growth Perspective**: is the foundation of any strategy and focuses on the intangible assets of an organisation, mainly on the internal skills and capabilities that are required to support the value creating internal processes. It includes measures such as employee satisfaction, employee retention, employee skills etc.

3.7.1.1 **Aligning Employee Performance through Balanced Scorecard:**

The balanced scorecard approach can be used and applied at both the individual and the organisational level. It provides a balanced approach to evaluate the employees’ performance (for the purpose of performance appraisal) in a comprehensive manner rather than a partial view. In most of the organisations, the common practice of measuring the employee performance refers to only the comparison of their action plans and behaviours with the standards set i.e. without actually measuring the results of their actions like profits and increase in market share. This conventional practice can lead to the appraisal of most of the employees without any or little progress towards achieving the goals and objectives of the organisation. Thus, the balanced scorecard gives the complete view of the employees and the organisational performance and helps to align the employee performance/action plans with the organisational goals

3.7.1.2 **Benefits of Balanced Scorecard**

The benefits of the balanced scorecard approach in measuring performance are:

1. It gives the complete picture of the employee as well as the organisational performance.

   - It guides users in determining the critical success factors and performance indicators.
   - Strategic review or analysis of the organisational capabilities and performance.
• Focusing the whole organisation on the few key things needed to create breakthrough performance.
• Integrating and directing the performance and efforts from the lowest levels in the organisation to achieve excellent overall performance.

3.7.2 HR Scorecard:

Based on various studies, it can be concluded that firms with more effective HR management systems consistently outperform the competition. However, evidence that HR can contribute to a firm’s success doesn’t mean it is now effectively contributing to success in business. It is a challenge for managers to make HR a strategic asset. The HR scorecard is a lever that enables them to do so. Implementing effective measurement systems for intangible assets is a very difficult task and demands the existence of a unified framework to guide the HR managers. It is this difficulty that has been the prime reason why managers tend to avoid dealing with intangible assets as far as possible. In the process firms under-invest in their people and at times invest in the wrong ways. Another difficulty is, managers cannot foresee the consequences of their investments in intangible human assets in a well-defined measurable manner and they are not willing to take the risk. Thus, the most effective way to change this mind-set is obvious – to build a framework just like the Balanced Scorecard, which has sound measurement strategies and is able to link HR functions, activity and investment with the overall business strategy. The HR scorecard framework was specifically designed for these purposes.

The HR Scorecard is a powerful way for HR professionals with their benefits as follows

1. Focusing on leading indicators:

There are leading and lagging indicators in the overall balanced performance measurement system, there are drivers and outcomes in the HR value chain as well. It is thus important to monitor the alignment of the HR decisions and systems that drive the HR deliverables. Assessing this alignment provides feedback on HR’s progress towards these deliverables and lays the foundation for HR’s strategic influence.

The scorecard links HR decisions and systems to HR deliverables which are, in turn, the performance drivers for fulfilling the organization’s strategy implementation and performance goal attainment.
2. **It lets HR professionals effectively manage their strategic responsibilities:**

The scorecard encourages HR managers to focus on exactly how their decisions affect the successful implementation of the firm’s strategy. This is due to the systemic nature of the scorecard. It provides a clear framework to think in a systemic manner.

3. **It enables cost control and value creation:**

It allows HR professionals to drive out costs where appropriate, but at the same time defend investments in intangibles and HR by outlining the benefits in concrete terms.

4. **Identifying the differences between HR do-ables and HR deliverables**

An appropriate HR measurement system will encourage HR professionals to think both strategically as well as operationally.

5. **Encouraging HR flexibility and change**

By maintaining its focus on the organization’s strategy implementation, the HR Scorecard highlights the importance of HR’s flexibility and adaptability which constantly undergoes change in response to the environment and other strategic challenges. In a strategy-focused organization, people view the measures as a means to an end rather than an end in them.

6. **Demonstrating HR’s contribution to strategy implementation:**

The cumulative effect of the HR Scorecard’s deliverable measures provides the answer to the question regarding HR’s contribution to firm performance. All measures have a credible and strategic rationale. Line managers can use these measures as solutions to business problems. It provides HR with a focused, credible, and clear strategic rationale for their work in service to the organization.

3.7.3 **Total Performance Scorecard**

Total Performance Scorecard is defined as the systematic process of continuous, gradual, and routine improvement, development and learning, focused on a sustainable increase of personal and organizational performances. This management concept encompasses the personal and organizational mission, vision, key roles, core values, critical success factors, objectives, performance measures, targets and improvement
actions, as well as the resulting process of continuous improvement, development and learning.

It consists of the following elements:

- **The Personal Balanced Scorecard (PBSC)**: entails the total idea of personal mission, vision, key roles, critical success factors, objectives, performance measures, targets, and improvement actions (Rampersad, 2003). The PBSC regards the continuous improvement of your personal skills and behavior, focusing on your personal well-being and success. Self-management stands central here and focuses on the managers as well as employees within the entire organization.

- **The Organizational Balanced Scorecard (OBSC)**: encompasses the total organizational mission, vision, core values, critical success factors, objectives, performance measures, targets and improvement actions (Kaplan & Norton, 1996). The OBSC regards the continuous improvement and controllability of business processes focusing on achieving competitive advantages for the company. This corporate BSC is communicated and translated into all business unit BSCs, team BSCs and the performance plans of individual employees. The organizational improvement actions are implemented according to the Plan-Do-Check-Act cycle of Deming (Deming, 1985).

  This cycle consists of the following 4 phases:

  1) *Plan* (develop an improvement plan);
  2) *Do* (execute this improvement plan on a limited scale);
  3) *Check* (review the results of the improvement actions; and
  4) *Act* (implement the proven improvements).

- **Total Quality Management**: It encompasses a disciplined way of life within the entire organization whereby continuous improvement of oneself, one’s job and the organization stand central. Defining problems, determining root causes, taking actions, checking the effectiveness of these actions and reviewing business processes are done here in a routine, systematic and consistent way (Rampersad, 2004). The emphasis is on the mobilization of the entire organization in order to continuously satisfy the needs of the customer. It is a philosophy as well as a set of guidelines forming the basis for a continuously improving organization using the Deming cycle. This learning cycle (PDCA-learning) is used in the TPS concept for process improvement.

- **Competence Management**: Competence Management encompasses the process of the continuous development of human potential within the organization. The goal of
Competence Management is continuously delivering top performances with a motivated and developed community. It focuses on the maximum development of employees and makes optimal use of their potential in order to achieve the goals of the organization.

Competence management involves the development of job-related competences; a collection of information, capabilities, experience, skills, attitudes, standards, values, views, and principles (knowledge) that is focused on the expert fulfilment of your job.

The development cycle is central here, which consists of the following phases:

1. Result planning,
2. Coaching, appraisal, and job-oriented
3. Competence development.

- Kolb’s Learning Cycle

This process of *instinctive learning* (learning by experience) is seen in all four management concepts mentioned. Together with the process of *conscious Learning* (learning by education) they result in individual and collective behavioral changes. These two learning forms as well as *individual learning based on the PDAC cycle, PDCA-learning based on the Deming cycle* and *collective learning* is important themes in the TPS-concept. These are used to create conditions for effective organizational change. Kolb’s learning cycle contains the following four phases (Kolb, 1984): Gaining hands-on experience, observing this experience, drawing conclusions from this experience, and testing these ideas in experiments, which again will result in new behavior and experiences.

### 3.7.4 Six-Sigma Philosophy

Six-Sigma is primarily a management philosophy that attempts to improve upon customer satisfaction to near perfection. Six Sigma is the smarter way to manage a business or a department by managing with facts, figures and data. Herein, the overriding philosophy is ‘customer satisfaction’. The objective of Six Sigma is to drive process improvements by focusing on defect elimination, rather creating and improving products/services that results in a very small number of defects. Six Sigma equals to 3.4 defects parts per million opportunities. This says a six sigma company has little more than, 3 bad customer experience (3.4) for every million opportunities. As per Pande
Six Sigma efforts target the main areas of improvement as given below:

1. Improves customer satisfaction
2. Reducing cycle time
3. Reducing defects

There are main five breakthrough strategies of Six Sigma philosophy (D-M-A-I-C) as under:

- D- Define : The goals of the improvement activity
- M-Measure: The existing system
  - Analyse: The system to identify ways to eliminate the gap between the current performance/process and
- I-Improve: the existing system
- C-Control: The new system

3.8 CONCLUDING REMARKS:

The success of any performance management system is influenced by the effectiveness of its appraisal system. The present chapter takes the conceptual review of performance management. The various issues like performance appraisal process, methods, characteristic of an effective performance appraisal system etc. have been covered in detail. It also covers the concept of KPI and explains various financial performance indicators which can be useful for measuring organisational performance. Modern methods of performance measurement such as Balanced Scorecard, HR scorecard, Total performance Scorecard and Six Sigma are also discussed at the conclusion of this chapter.