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SOUNDS GOOD BUT ...

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Getting rid of the bottom 10%, sounds good but…
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Jack Welch, the now retired CEO of General Electric, has been the most articulate and persistent advocate of removing poor performers from organizations. At GE it's the bottom 10% that is supposed to be removed every year. Welch feels so strongly about the issue that he advocates it in his 1999 shareholder letter, and his new book, "Jack: Straight From the Gut". In addition to arguing that it is good for organizations, he argues that it is good for individuals because it removes them from a situation in which they are failing and have a poor future. GE is not alone in using forced ranking or distribution systems to systematically remove poor performers. Similar policies have been used by Ford, Conoco, Sun Microsystems, Cisco, EDS, and a host of other US corporations.

At first glance it makes a lot of sense to eliminate the worst employees. In many cases they can be replaced by better employees and the performance of the organization improved. Ridding the organization of poor performers also sends a strong message that the organization is performance oriented and does not tolerate poor performers. But is a system that makes managers select a quota of low performers who are forced out the door really the best way to become a high-performance organization? My research suggests it is not. However, it does show that tolerating poor performance is very destructive because it can ultimately lead to a negative-performance culture in which it is OK to be a poor performer, and where good performers leave because they do not want to part of an organization that tolerates poor performance. Dealing effectively with poor performers clearly can elevate the overall level of talent of an organization and motive everyone to perform better. The important issue for me is one of method, not of objective.

Successfully removing poor performers requires, first and foremost, the ability to identify who they are. Only if this can be done effectively does it makes sense to talk about the advantages and disadvantages of actually forcing them out of the organization. Most employees do not feel that they are poor performers and, in fact, my research shows that over 80% of the employees in most organizations feel that they are average or better performers. Thus, when the call for poor performers goes forth there are typically few, if any, volunteers.

It is hardly surprising that most individuals see themselves as good performers. What is more surprising is that the managers often are unwilling to identify any of their subordinates as individuals who should be fired. There are numerous reasons for this including a lack of courage, concern about what will happen to individuals they feel responsible for, the disruption that firing employees causes them, and the lack of good measures to identify who the poor performers are. It is because most supervisors are hesitant to identify poor performers that organizations require that each supervisor or department identify some fixed percentage of employees, typically 5% or 10%, who are poor performers. Faced with this bureaucratic solution to the problem of identifying who the poor performers are, most supervisors ultimately acquiesce, but do they identify the right employees?

Downside of the Curve

The assumption that the bottom 10%, or so, of employees can be identified and should be eliminated rests on the assumption that the performance of individuals fits a normal distribution

(Welch calls it the "Vitality Curve"). It is, a distribution where there is a large number of average employees and a small number of outstanding and poor performers who clearly stand out because they are separate from the large middle group. They, in effect, represent the tails of a normal distribution. In some cases, of course, the employees in a work group or a department do fit this distribution, but there is no reason to assume that they always, or even frequently, do.

Normal distributions consistently occur only when random events occur and there is a large sample. A large sample for statistical purposes means thousands, not 10, 20, 30, or even 100 individuals. Further, in most work situations individuals are not randomly placed in jobs and asked to perform, they are selected, trained, and motivated to do their jobs. Thus, in many corporations the performance of individuals is a carefully planned and controlled event. Because the performance of individuals in a work area often does not follow a normal distribution, significant problems can occur when managers are asked to identify a certain percentage of poor performers.

First, there is a very real danger that some satisfactory employees will be identified as poor performers. The reason for this is simple: there are some work areas that are simply better staffed than others. Thus, individuals who are satisfactory, or even outstanding performers will be identified as poor performers simply because they happen to be with a group of very good employees. Clearly, from an organizational performance point of view, the right thing is to strengthen the areas where there are a number of poor performers by replacing them, not removing employees from an area which is dominated by good performers. Although this is the ideal, most forced distribution systems do not produce this result because they demand that every department or work area come up with a certain percentage of poor performers.

In addition, there may be a large number of employees who are essentially similar in performance and no individuals who are clearly poor performers. This means a supervisor often has to separate essentially identical individuals, targeting some for dismissal and others for retention. It is hardly surprising that a supervisor might resist doing this, and that doing it creates charges of unfair treatment.

Over the last few decades there have been numerous court cases involving forced distribution and forced ranking systems in companies. They are particularly open to court challenge when they have an adverse impact on protected groups. Courts have said that an adverse impact is acceptable only if it can be proven that the impact is a result of actual performance deficiencies on the part of the individuals who are negatively affected. In other words, if the company can prove that the performance appraisal is valid, then there is no problem with a disparate effect. However, because of all the problems that have been mentioned so far, particularly those concerned with measurement, it is very difficult to prove that the performance judgments reached by supervisors are, in fact, valid. Years ago I was an expert witness in a class action age discrimination case against Sandia Corporation that focused on the validity of their performance appraisal system. Sandia lost the case precisely because they could not prove that the distinctions required by the forced ranking performance appraisal system were, in fact, valid. Recently, Ford, reacting to the same problem, decided to abandon its forced distribution system after it was threatened with lawsuits.

Identifying poor performers is particularly problematic when it is done year after year, and each year the poorest performers are eliminated. The first year it is often relatively easy to do because there are a few individuals who have performance problems that, for various reasons,

simply have not been dealt with. Once they are eliminated, however, the tail, or lower end of the distribution is gone and, unlike salamanders, normal curves do not grow new tails automatically. They develop them only if the "replacements" who are hired turn out to be poor performers, or some existing employees suddenly develop serious performance problems. Since neither of these is very likely to occur, there may be no poor performers and supervisors resist coming up with new lists of poor performers year after year. Welch, indeed, notes this in his book, when he says that by the third year of forced distribution ratings "it's war". Welch, of course, argues it is important to win the war and to keep identifying poor performers. But is it? Managers often resist identifying a bottom 10% for good reason: there is no bottom 10% that is easily identifiable. Welch's solution to this problem is to force managers to differentiate and to put managers in the bottom 10% if they cannot differentiate.

Measuring Performance

It is one thing to evaluate the performance of sales people with similar territories and production workers with quantitative production goals, it is quite another to measure the performance of knowledge workers who work in teams to produce software code, new product ideas, advertising campaigns, etc. Inevitably, the assessment of knowledge workers is a subjective one that depends very much on a supervisor being able to set goals, measure performance against those goals, and gather input from peers and customers with respect to the performance of individuals.

Given the problems with measuring performance and identifying the worst performers it is critical that organizations create effective performance management systems before they require managers to identify their poor performers. Training and comprehensive performance data are needed in order for managers to do an acceptable job of measuring performance. For example, the use of balanced scorecards and ERP systems can increase the amount and quality of data managers have to use for performance measurement. Finally, it is important that managers be evaluated on how well they measure the performance of their subordinates.

Hidden Costs of Firing Poor Performers

Clearly, if it is impossible to accurately identify the poor performers in an organization it makes little sense to have a policy which calls for letting them go on an annual basis. But what if a reasonably good job can be done of identifying them? The up-side of letting them go is obvious, but it is important to consider the problems associated with it.

Perhaps the major problem with firing poor performers is the cost of turnover. Just as voluntary turnover can be quite expensive, so can forced turnover. In fact, forced turnover may be more expensive because it requires settlements, the continuation of benefits, and may result in law suits. There also are the replacement costs of finding someone, training them, and waiting for them to develop the relationships and knowledge they need in order to be a fully productive employee.

There is a considerable amount of research on the actual cost of turnover and it suggests that frequently it is equal to at least one year's salary of the employee who is replaced. Further, unless the employee who is let go is clearly an inferior employee it may, in fact, end up that the new-hire is no better, or only slightly better, than the employee who has left, and all that has been produced is an expensive termination and hiring process. As a result, it may take a

considerable amount of time before the organization gets a financial return on replacing poor performers, particularly if the work involved is complex and involves a considerable amount of learning and dealing with others.

In some labor markets there simply are no people available, much less better people available, to replace the employees who are identified as poor performers. This, of course, varies depending upon the economic cycle and the type of skills departing employees have, but it is particularly likely to be true for knowledge-work jobs in growth industries such as information technology, bio-tech, and professional services. In a situation where firing somebody rids the organization of a poor performer but creates a job opening that is extremely difficult to fill, it often does not make sense to dismiss the poor performer.

Managers who are mandated to come up with a certain number of poor performers every year often behave in ways that are intended to beat a system which they think is dysfunctional. They manage to the reduction number they are given by keeping bad employees around until the performance-rating period comes around. Instead of firing someone earlier in the year when it might not count toward their quota of poor performers, they tolerate poor performance until the end of the year so that they have somebody to offer-up as a poor performer. If they have more poor performers than they need to meet their quota, they keep them around so they will have some for the next found of appraisals.

The requirement that managers identify poor performers so they can be eliminated may also influence how managers develop their employees. It hardly makes sense for a manager to develop individuals who are marginal performers when, in fact, the supervisor knows that in a relatively short period of time they will need to identify them as poor performers. In some respects the logical thing for a manager to do is to invest his or her development dollars and effort in individuals who are likely to survive the annual performance assessment and firings.

Supervisors tend to disown the appraisals when they are forced to identify poor performers. They say to individuals, "Well, I know you're not really a poor performer, but I have to identify somebody as a poor performer, and you are the unfortunate individual." By disowning the appraisals supervisors discredit the entire system and significantly contribute to the negative perceptions of the entire performance management system.

Finally, a forced distribution system that leads to firings creates competition among peers. When employees in a work area compete with each other for ratings they are much less likely to help each other out, train each other, share information and operate as an effective team. In today's flatter, more team-based organizations, this can take a significant toll on organizational performance.

Effectively Dealing with Poor Performers

Given the advantages of dealing with poor performers and the problems with forced distribution ratings and firings, what is the best approach? Simply stated, I believe organizations need to substitute leadership and judgment for bureaucracy and rules. Organizational systems which require managers to fire a certain percentage of poor performers every year are a bureaucratic solution to a leadership problem. They substitute a rule in order to correct for the poor leadership behavior of managers, but they create, in many cases, an even worse problem. What is needed is a senior management group that takes talent management extremely seriously and leads a rigorous annual talent evaluation process in the organization.

At the core of an effective talent evaluation process must be a well-executed performance appraisal system which ensures that all individuals are accurately assessed on their performance and potential. It needs to go beyond simply measuring performance to consider the causes of poor performance and possible solutions other than dismissal. When poor performance is caused by a poor person-job fit the best action may be to transfer the poor performer to a new job, even if it means a demotion. Alternatively, a development plan may need to be developed to improve the skills of the individual. If motivation is a problem, a cut in pay with the promise of an increase if performance improves may be the best action. Finally, how easy it is to replace poor performing individuals should be taken into account in deciding what action to take.

In order to assure managers do a good job of performance appraisal organizations need to collect data on how well managers do performance management and reward them accordingly. Their bonuses and career development need to be tied to the quality of their appraisals and to how well they develop their employees. If they lack the skills to do performance management they need to be trained.

Senior management led cross-calibration meetings are a good way to assure that appraisals are done properly. In these meetings multiple employees are reviewed and their performance ratings determined. They are a good way to assure that employees who are rated poorly in one part of the organization would be rated at a similar level in other parts of the organization. In essence, it is a way to avoid the "good group / bad group" problem that exists with forced distribution systems. It may well be that a manager does have all outstanding subordinates and rates them accordingly, but the manager must be able to defend this assessment in a meeting of peer managers and executives.

Leadership is critical in conducting effective cross-calibration meetings, in establishing a culture where performance management is taken seriously, and in making informed judgments about how individuals are developed and rewarded. How many individuals should be let go, how many should be placed in the different categories of an appraisal system, and the answers to a host of other human capital management questions need to be the outcome of a senior management led analysis of the business situation, the capabilities and performance of the organization, and the business strategy. They should not be based on an arbitrary bureaucratic guideline.

Having an effective performance management system and making good judgments about who to retain, who to dismiss, and who to develop are likely to become an increasingly critical organizational capability. Hopefully the importance of this capability will cause organizations to move beyond arbitrary bureaucratic rules and policies to systems and practices which are led by managers who understand the importance of human capital, and who make informed, thoughtful decision about human capital management.