PERFORMANCE MANAGEMENT: LINKING STRATEGY AND HUMAN RESOURCES

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Abstract

This paper reviews the development of performance management, presenting the major perspectives of this important area of human resource management. Our concept of performance management involves several aspects: links with organizational strategy, establishment of individual goals, feedback on progress, opportunities for improvement and development. We also note that performance management systems will vary acording to the characteristics of the organization and its environment; for example, multinational enterprises face significant complexity in developing, implementing and maintaining performance management processes.

Performance management is the process through which employees and managers ensure that employees' activities and outputs are congruent with the organization's goals. Performance management is central to gaining competitive advantage. Companies that seek to gain competitive advantage through employees must be able to manage the behavior and results of all employees. Performance management is one component of an organization's control system. Our concept of performance management involves several aspects: links with organizational strategy, establishment of individual goals, feedback on progress, opportunities for improvement and development. We also note that performance management systems will vary acording to the characteristics of the organization and its environment; for example, multinational enterprises face significant complexity in developing, implementing and maintaining performance management processes.

PERSPECTIVES OF PERFORMANCE MANAGEMENT

Performance management, according to Lewis (1998: 67), "is a term used to describe an integrated set of techniques which have had an independent existence under their own names, e.g. [author's italics] performance appraisal". Broadly, performance management could be considered to comprise any intervention designed to improve employee performance. Consequently, it has been variously defined in the literature, resulting in a bipolarisation of views as to the precise nature of performance management. The narrow view is reflected in the use of the term 'performance management' to describe what is essentially performance appraisal linked to reward decisions (Bernthal, 1996). This may be considered simply a re-labeling of performance appraisal (Legge, 1995).

Other authors have broadened the term, extending it beyond the central activity of performance appraisal to involve other HRM activities and a strategic approach overall (Armstrong, 1994; Daniels, 1989). While no one definition of performance management prevails, it has become common practice to extend the concept of performance management beyond performance appraisal to a holistic or integrated, strategic approach. For example,

> a process for establishing shared understanding about what *is* to be achieved, and approach to managing and developing people in a way which increases the probability that it *will* be achieved in the short and longer term (Armstrong 1994: 23, author's italics).

Thus, performance management can be considered as the transformation of strategic objectives into action, monitoring progress, and rewarding results (Fenwick & De Cieri, 1995). It is therefore development-driven and reflects a normative or directive dimension. The latter is typified by Daniels' (1989) conceptualization of performance management as a data-oriented and systematic way of managing employees, using positive reinforcement as the key to maximising performance.

Expectancy theory and goal-setting theory have been identified as particularly relevant when discussing performance management (Clark, 1995). Expectancy theory hypothesises that employees alter their behaviour due to their anticipated satisfaction of valued goals. Goal-setting theory suggests that goals pursued by employees potentially play an important part in enhancing performance. Challenging or difficult goals provide directional cues and motivate employees to exert effort. Goals also encourage consideration of the performance and goal setting processes (Taylor & Pierce, 1999; Taylor, Renard & Tracy, 1998).

HISTORICAL CONTEXT OF PERFORMANCE MANAGEMENT

Although managers have generally sought to ensure continuous improvement and effective completion of tasks, 'performance management' has only emerged in the HRM lexicon since the late 1980s. Tahvanainen (1998) observed that the concept derives from management-by-objectives, a process reflecting the goal setting and performance appraisal traditions. Performance management is a reflection of two enduring

themes in the development of strategic human resource management (SHRM). The first theme is the evolution from personnel administration to HRM and then to SHRM. Increasing attention paid to organizational commitment has been a major aspect of this development. The second theme concerns the importance of integrating organizational and HRM strategy. Each will be briefly discussed in relation to performance management.

First, the evolution of HRM was influenced by the conceptual framework developed by Beer, Spector, Lawrence, Mills and Walton (1984). Known as the Harvard framework, this has provided a foundation for many of the developments made in HRM research (Legge, 1995). This framework recognizes a wide range of stakeholder interests and situational factors that influence HRM. HR policy choices relate to employee involvement, HR flows, reward systems, and work systems. HR policy choices result in outcomes of organizational commitment, competence and cost effectiveness, and in turn have long-term consequences for individuals, enterprises and society. Of particular relevance to the topic of performance management, in this framework HR functions and activities are seen as integrated in a system that is in turn integrated with the broader organizational strategy. There has been increasing attention, in SHRM research and practice, to the relationships between practices and organizational performance. This focus mirrors that which has dominated the strategic management field (Hoskisson, Hitt, Wan & Yiu, 1999).

The evolution of SHRM has included a progression from compliance-based to employee commitment-based achievement of organizational goals (Guest, 1992). Principal motives given for this progression have been the increasingly competitive business environment, and the need to gain competitive advantage through more effective use of employees. Guest (1992) suggested compliance-based control systems, based on low trust, are likely to emphasize direct supervision, work processes and outputs. In contrast, commitment-based control systems favour employee empowerment and self-management.

However, the focus of SHRM on commitment has been subject to critical analysis. For example, in addition to the motives for adopting commitment-based SHRM above, changing political and economic climates during the 1980s in some countries such as the United Kingdom (UK), led to a succession of legislation to reduce the power of trade unions. Trade unions were seen as barriers to increased employee productivity and efficiency. In these countries, new approaches to HRM were seen as a way of increasing employee involvement and bypassing trade unions. Guest (1992) suggested that the progression to commitment based HRM was much more difficult for established, unionized organizations in the UK than for those in the U.S., many of which were "greenfield" and or non-unionized sites. The differing definitions of performance management emerging in the literature might in part reflect the extent to which the process extends to unionised employees.

PERFORMANCE MANAGEMENT AND THE PSYCHOLOGICAL CONTRACT

Related to the role played by HRM in developing and maintaining organizational commitment is the notion of a psychological contract. This term is used to describe an employee's belief regarding the terms and conditions of a reciprocal exchange agreement between that employee and the employer (Robinson & Rousseau, 1994). Recently, this concept has received increasing levels of attention in HRM research and practice (see for example, Stiles, Gratton, Truss, Hope-Hailey & McGovern 1997). Guest (1992:113) suggested that the psychological contract in compliance-based HRM is summarised by a "[f]air days work for a fair days pay", while the psychological contract in commitment-based HRM is "[r]eciprocal commitment". Psychological contracts may be transactional (based on economic exchange theory) or relational (based on social exchange theory). The latter form has been linked to organizational commitment.

HRM policies and practices are instrumental in the formation of relationships between an organization and employee. In particular, performance management provides the system within which the psychological contract between employer and employee is formed. Understanding of the nature of the job together with equitable, accurate and timely performance evaluation, the provision of feedback about performance to employees and equitable distribution of development opportunities and pay are contract-making aspects of performance management (Stiles et al., 1997).

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As indicated earlier, the second theme in the historical context of performance management concerns the importance of integrating organizational and HRM strategy (see for example, Wright & McMahan, 1992). Lengnick-Hall and Lengnick-Hall typified the rationale for such integration when they hypothesised that an organization "that systematically and reciprocally considers human resources and competitive strategy will perform better" (1988: 468).

Through the 1990s, the number of scholars and practitioners who advocated the incorporation of human resources into the strategic formulation process increased. However, achieving such integration through the range of SHRM sub-fields such as human resource planning and performance management continues to be problematic (Fenwick & De Cieri, 1995; Legge, 1995). Further, problems with the notion of fit between strategy, HRM and organizational outcomes have also attracted both prescriptive and critical analysis (Delery, 1998; Wright & Snell, 1996).

Performance management, through its integration of several HRM functions and proposed linkage with organizational strategy, represents one intervention aimed at achieving strategic fit. Research suggests that, for performance management to be effective, it must be integrated with other organizational systems such as strategic planning and budget systems (Armstrong, 1994), and may be modified to meet differing organizational and business settings.

ELEMENTS IN A PERFORMANCE MANAGEMENT SYSTEM

Irrespective of the organizational setting, the following aspects have been identified characteristics of an integrated performance management system: links to organizational strategy; setting individual performance goals; providing regular feedback on progress towards those goals; providing opportunities for improving performance through appraisal feedback and training and development; and, links between results and rewards (Armstrong, 1994). Each of these characteristics is discussed in the following sections.

Links to organizational strategy

In the performance management literature, the need for links between performance management and organizational strategy, to achieve a shared vision of organizational objectives, has been emphasized. This involves all employees having a clear understanding not only of the organization strategy, but also of how that strategy impacts on and is influenced by their work performance. This understanding is a precursor for identifying individual performance criteria and work performance goals. However, Clark (1995) noted that designing a performance management system that meets the important criterion of distinguishing few, relatively specific goals might be problematic for three reasons. First, the organization may be unable to identify and communicate explicit and unambiguous strategic objectives. Second, restricting goals to a few critical ones, although consistent with goal-setting theory, might not be feasible in the context of organizations with complex structures and diverse operating environments. Third, the inherent instability of the strategic goals in many organizations might limit the extent to which strategy can be explicitly identified and communicated.

Performance Criteria

The basis of performance management is the determination of organizational criteria for performance. A criterion may be defined as a "dependent or predicted measure for judging the effectiveness of persons, organizations, treatments or predictors of behaviour, results, and organizational effectiveness" (Smith, 1976:745). Both quantitative and qualitative criteria are necessary for effective performance measurement and management (Kaplan & Norton, 1992). Performance criteria may be classified according to time-span covered, specificity and closeness to organizational goals. In essence, it is important for performance criteria to be relevant, practical and reliable.

One popular framework for linking strategic organizational objectives to individual performance, the 'balanced scorecard', exemplifies attempts to address the problems of determining appropriate measures of effective performance. The 'balanced scorecard' identifies four critical perspectives on organizational performance; the financial perspective, the internal business perspective, the innovation and learning perspective and the customer

perspective (Kaplan & Norton, 1992). Originally a framework of organizational performance measures, the 'balanced scorecard' has been extended to HRM and the performance management of individuals (McKenzie & Shilling, 1998).

Setting Individual Performance Goals

Work performance goals covering both the means and ends of performance expectations for employees can be established when both the knowledge of the transformation process and the measurability of output are clear (Flamholtz, Das & Tsui, 1985; Ouchi, 1979). In control terms, goal setting is said to be critical for organizations seeking to "increase the probability that individuals and groups will behave in ways that lead to the attainment of organizational goals" (Flamholtz et al., 1985: 36). In performance management terms, this process should occur with extensive employee involvement and in the context of both the immediate position and the whole organization. Tasks to be performed by employees are usually communicated in the first instance in the position or job description (Cascio, 1991). This description is also important in the socialization of organizational members, to enhance an individual's ability, motivation and understanding of what is expected for job performance. This allows individuals to make sense of unfamiliar or new work contexts and to adapt their performance accordingly, to achieve favourable outcomes.

Providing Feedback on Progress Towards Goal Achievement

Feedback "as part of a control system refers to the information provided about work behaviour and outcomes" (Flamholtz et al., 1985: 41). Feedback controls the work behaviour of organization members by directing behaviour through the provision of information necessary for corrective action. Also, it motivates behaviour by acting as a promise for future rewards. As mentioned in the previous section, work goals covering both the means and ends of performance expectations can be established when both the knowledge of the transformation and the measurability of output are clear. Ouchi (1979) specified that feedback about behaviour is appropriate when perfect knowledge of the means-ends relationship in the transformation process exists. Feedback about output is appropriate when the knowledge about the transformation process is imperfect, but when the outcomes can be measured with certainty. Relatively little empirical work has been conducted with regard to employees' preferences regarding the process and content of performance management. However, in one such investigation, employees have been found to favour informal, ongoing feedback about their performance, and feedback that focuses on performance outcomes and future development (Gosselin, Werner & Hallé, 1997).

Therefore, feedback through the performance appraisal activity is central to performance management and has two distinct purposes, evaluation and development. In addition to generating a consistent set of performance standards, better performance appraisal systems can enhance productivity by giving ongoing feedback and by assessing performance and not personal characteristics (Cascio, 1991). Behaviourally-based performance appraisal approaches have been advocated as less subjective means of evaluating and developing employee performance. However, Gomez-Mejia (1988) proposed that more attention should be given to how tools such as behaviourally anchored rating scales are integrated within performance management (for example, in the establishment of performance criteria and work plans, feedback, promotion discussions and HR planning). Recognising that employees and managers become cynical about forms/approaches that do not appear to relate to other organizational processes in meaningful ways, one valuable contribution of feedback mechanisms in performance management is to provide the opportunity to review the performance management system itself (Clark, 1995).

Questions of who conducts performance appraisals, how and based on what data, remain high on the research agenda. These have been reflected in recent developments such as multiple rater (360-degree) feedback and competency-based performance appraisal techniques (see for example, Albright & Levy, 1995; London & Smither, 1995). Multiple rater appraisals aim to extend the perspectives of ratee performance to include feedback gained from peers, subordinates and relevant others. It is, however, suggested that ratees most trust their immediate superior as the source of accurate performance appraisal and feedback (Gosselin et al., 1997).

The mention of trust in the performance management process raises related criticisms concerning the politics and power relationships inherent in the performance appraisal process. Performance appraisal as a source of performance feedback has been criticized as being at the very least subjective and politically driven (Gioia & Longenecker, 1994) and at the most as surveillance, even institionalized subjugation (Coates, 1994).

Recent research highlights some differentiation between outcomes for women and men of performance management generally (White, 1999) and 360 degree feedback specifically (Fletcher, 1999). Reporting on the 1992 Employment in Britain survey, White concluded that women were more responsive than men to performance management but there appeared "a systematically lower exposure of women to the developmental systems of performance management" (1999: 53). According to Fletcher's (1999) review of international research on gender differences in 360-degree appraisal and self-assessment, women tended to rate themselves less positively than men and were less subject to leniency effects. Although the tendency toward greater openness and self-disclosure evident in women ratees is conducive to a more effective performance appraisal process from the organization's perspective, placing more trust in the fairness of the performance appraisers has "put women candidates at a disadvantage" (Fletcher, 1999: 42).

Providing Opportunities for Improvement Through Appraisal Feedback and Training and Development

As previously mentioned, performance appraisal feedback has a developmental purpose. Providing opportunities for improvement through appraisal feedback and training and development is an ongoing performance management activity aimed at continuous improvement. Herbert and Doverspike (1990) reviewed literature concerning the use of performance appraisal as a training needs analysis technique and concluded that the ideal strategy includes a comprehensive, behaviourally-based rating scheme.

While performance feedback is useful, in order for skill improvement to occur, the provision of developmental opportunities is critical (Fisher Hazucha, Hezlett & Schneider, 1993). Poor performance resulting from lack of ability or lack of knowledge may be improved by skill development activities such as training or temporary assignments. When employees show strong performance, this may also lead to developmental opportunities, as a means to enhance long-term career management, job satisfaction and motivation for employees, and to achieve organizational performance goals (Olian, Durham, Kristof, Brown, Pierce & Kunder, 1998). Further, with regard to the psychological contract, the provision of training and development as part of the performance management process is symbolic of employees' value to their organizations (Stiles et al., 1997).

Links Between Results and Rewards

SHRM research has emphasised the need to link performance to extrinsic and intrinsic, monetary and non-monetary rewards (Bloom & Milkovich, 1996; Kessler & Purcell, 1995). The underlying assumption has been that individuals can be motivated to perform more effectively and efficiently if there is a direct link between their effort and reward. In terms of the expectancy-theory tradition, it is the anticipated satisfaction of valued goals that motivates employees to alter their behaviour in ways most likely to result in goal attainment (Clark, 1995). According to expectancy theory, employees' perceptions of the existence of strong links between their meeting performance goals and rewards for having done so are critical. However, as employee perceptions are likely to change when practice conflicts with them, effective performance management is contingent on the existence of these links in the system. The reward system usually has the greatest effect of all HRM interventions on employee behaviour (Stiles et al., 1997).

One of the emerging issues in reward management has been the transition from its role as a control function to one of supporting commitment-based HRM by providing a share in the financial success of the organization (O'Neill, 1995). Implicit in this transition has been the need to link reward outcomes to individual contributions by differentiating performers and non- or under-performers. Since the 1980s, adoption of performance-based or performance-related pay as a component of reward management has proliferated in both private and public western organizations (Bloom & Milkovich, 1996).

Performance-related pay is one means by which organizations signal strategic intent and create an entrepreneurial and self-motivated work environment. Fundamental in determining the extent to which

rewards act as motivators for employees are their perceptions of the fairness of the reward management process (Stiles et al., 1997).

Another fundamental and enduring theme in the reward management literature is that pay levels, in order to induce performance, must be high enough in absolute terms and also distinctive enough to highlight differences in effort, contribution and human capital within organizations (Bloom, 1999). The complexities inherent in this process have revealed themselves in several problems that impede the effective management of performance-related pay. These include measurement issues, particularly that of measuring individual contributions to interrelated performance; and, performance appraisal feedback and acceptance issues, particularly reluctance by employees to agree with their performance appraisals or evaluations lower than their own self-evaluations. Other problems concern reward desirability; system 'noise', such as the timing of merit pay and reward system inconsistencies; and, unintended consequences such as outcome-focused performance. To address such problems, a reward system should reflect the optimum benefits of merit pay systems by stimulating performance with meaningful and attainable goals, and displaying transparent equity (Bloom, 1999).

Performance Management in Multinational Enterprises

The globalization of business increases the need to understand ways in which multinational enterprises (MNEs) may operate most effectively now and in the future. Differences between business in a domestic market and international markets exist at both conceptual and practical levels; MNEs have characteristics that differ significantly from domestic enterprises. HRM, and performance management in particular, are recognized as critical to organizational performance in global markets (Dowling, Welch & Schuler, 1999).

In an MNE, performance management occurs across national and cultural boundaries. Therefore, each of the characteristics of an integrated performance management system discussed in the sections above must be considered with regard to all MNE employees (Fenwick, 2000). To achieve links with MNE organizational strategy, the identification of relevant, practical and reliable performance criteria upon which performance goals are based, must recognise the control context in which the MNE operates (Pucik & Katz, 1986; Schuler, Fulkerson & Dowling, 1991). Performance management may also take into account contextual elements, such as currency fluctuations that influence the financial performance of the local unit. The use of multiple performance criteria is recommended, to reduce bias and to acknowledge the multi-dimensional nature of the MNE environment. Long-term goals and appraisal criteria need to be flexible enough to cater for volatility in the international environment and changes in the strategic direction of MNE subsidiary units (Dowling et al., 1999).

Cultural differences in the nature of performance goals and acceptability of individual participation in goal setting have also been noted (Rubienska & Bovaird, 1999). For example, Tahvanainen (1998), in her case study research of a large Finnish MNE, found that employees in Germany and Sweden commonly participated in goal setting for their jobs, but those in the U. S. tended to have their job goals assigned.

Within the MNE, issues central to performance management may become more complex managerial challenges. For example, those enduring issues of who conducts performance appraisals, how and based on what performance data, may be intensified. Further, the extent to which performance appraisal and feedback are interpreted with distrust or as an insult differs across cultures (Rubienska & Bovaird, 1999).

Much of the literature and research related to performance management in MNEs has been focused on expatriate employees. For example, much expatriate training and development appears to have been focused on developing their ability to adjust to a new culture. Certainly, cross-cultural adjustment has been shown to enhance expatriate performance (Dowling et al., 1999). However, providing ongoing opportunities for improvement, through appraisal feedback and training and development is a performance management process aimed at continuous improvement and socialization to desired organizational practices.

In MNEs, management of links between performance and rewards is complex, due to the specialized local knowledge required across multiple employment and legal environments. Further, the objectives of international compensation present significant challenges (Bonache & Fernández, 1997). These objectives are to: achieve and maintain internal consistency, attract and retain staff to the requisite areas in the MNE,

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facilitate efficient international staff transfers and duly consider equity and ease of administration (Dowling et al., 1999). Considering these challenges and the issues outlined above, overall, it is evident that MNEs provide a complex context for performance management.

Conclusion

Performance management has been discussed as a complex, holistic activity with interaction occurring across a "bundle" of HRM practices (Delery, 1998). Thus, performance management reflects both vertical and horizontal fit, by enabling alignment of HRM practices with the particular organizational context and enhancing internal consistency and complementarity of HRM practices. By implication, therefore, performance management is contingent upon and in turn contributes to the organization system in which it is embedded.

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