Organizational Dynamics, Vol. 32, No. 4, pp. 396–404, 2003

www.organizational-dynamics.com

ISSN 0090-2616/$ – see frontmatter
doi:10.1016/j.orgdyn.2003.08.007

Available online at www.sciencedirect.com
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LEARNING FROM PRACTICE

Reward Practices and Performance Management System Effectiveness

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Virtually every organization has a performance management system that is expected to accomplish a number of important objectives with respect to human capital management. The objectives often include motivating performance, helping individuals develop their skills, building a performance culture, determining who should be promoted, eliminating individuals who are poor performers, and helping implement business strategies. There is little doubt that a performance management system which can accomplish these objectives can make a very positive contribution to organizational effectiveness, but there is less clarity about what practices make a performance management system effective.

There are a large number of design features that potentially can influence the effectiveness of a performance management system, and many of these have been empirically studied to determine their impact. For example, there is considerable research which shows that performance management effectiveness increases when there is ongoing feedback, behavior-based measures are used and preset goals and trained raters are employed. There is one potential determinant of performance management system effectiveness, however, which has received relatively little attention: how tightly the results of the performance management system are tied to significant rewards. The lack of attention to this impact is particularly pronounced when it comes to the issue of using a performance management system to systematically remove lower-performing employees from the organization.

There are a number of reasons for believing that systematically tying rewards to the outcome of a performance management system will make the performance management system more effective with respect to motivation, but there are also some that suggest it will make it less effective with respect to development. In a well known 1965 article that is based on research done in General Electric Co., Meyer, Kay and French argue that when rewards are tied to performance discussions, individuals tend to hear only the reward system part of the message. They do not hear the kind of useful feedback that will allow them to improve their performance and develop their skills. This has led some companies, although not G.E., to separate the discussion of rewards from the discussion of performance.

On the other hand, it is reasonable to argue that when rewards are tied to the outcome of performance appraisals it will lead to more effective performance management systems. Managers will be particularly concerned about doing a good job, since the outcome of the appraisal will have a significant impact on their ability to allocate rewards based on performance and motivate those individuals who work for them. Similarly, in the case of individuals, they know that how well the performance review goes will effect rewards that are important to them, so they may be particularly motivated to prepare for the session and see that it goes well. Further, there is a good possibility that when appraisals are used to determine rewards, organizations will put more pressure on managers to differentiate among the employees they are appraising since this is key to rewarding individuals for their performance.

At this point in time no discussion of a performance management system can completely ignore the increased popularity of forced distribution and seriatum ranking systems. Ranking systems that force managers to place their employees in a 1 to *N* order based on their performance have existed for decades. They are frequently used in research laboratories (e.g., Sandia, Lawrence Livermore) and often place hundreds or even thousands of employees in a single ranking. Forced distribution systems which require that managers identify a predetermined percentage of their employees as poor performers and outstanding performers have become more popular in the last decade. General Electric's forced distribution approach has received a great deal of publicity. Other adopters of this approach include Intel Corp., Ford motor Co., Goodyear Tire & Rubber Co., Enron Corp., Capital One Financial Corp., and Electronic Data Systems (EDS) Corp.

General Electric's former chief executive officer (CEO) Jack Welch is among the most vocal and articulate advocates of forced distribution performance management systems that force turnover of the lowest-performing employees each year. At GE, it's the bottom 10 percent of employees who are supposed to be eliminated. Mr. Welch feels so strongly about this practice that he highlighted it in his 1999 letter to GE shareholders and advocated it again in his book *Jack: Straight from the Gut*. In addition to arguing that a forced distribution system is good for organizations, he states it is good for individuals, because it takes people who are failing out of situations that are bad for them and the company.

There are many criticisms of the forced distribution approach, including the arguments that it represents an unrealistic mandate, and that it may force managers to make judgments they cannot support with data and do not believe in. Because of this it can lead to decisions that cannot be defended when there is an adverse impact. On the other hand, its proponents argue that it puts a rigor and discipline into the performance management system that overcomes the all too common leniency tendencies of managers. The key question, of course, concerns whether or not using a forced distribution system in combination with rewarding performance makes a performance management system more effective or less effective.

RESEARCH METHOD

Questionnaire data were collected by mail from 55 Fortune 500 companies on their