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Commentaries

The Fate of Performance Ratings: Don't Write the Obituary Yet

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In the focal article, Pulakos, Mueller Hanson, Arad, and Moye (2015) have noted that performance management (PM) too often consists of intermittent steps (e.g., end-of-year performance review ratings and meetings) that are not connected to day-to-day work. With regard to performance ratings, Pulakos et al. (2015) have pointed out that it can be "demotivating and disengaging for employees to have their performance boiled down to a single number, with which they are then labeled, unless it is the highest rating or ranking that is available" (p. xx). The authors have also noted that managers sometimes retrofit their ratings to justify the pay increases that managers want to give employees (sometimes for reasons unrelated to the employee's level of performance). Pulakos et al. have also offered a case study of one organization, Cargill, which has abandoned ratings. Although Pulakos and colleagues have pointed out that not all organizations should eliminate ratings, the authors have argued that when there are small differences in pay increases across employees, ratings can be removed with relative ease and little consequence. Pulakos and colleagues have therefore suggested that organizations should consider the impact that ratings have on decision making (and have suggested that this impact is often smaller than one might think).

Here I describe several reasons that make it unlikely that many organizations will abandon ratings (and their links to pay increases). These reasons are derived from research in psychology, behavioral economics, and decision making.

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The Status Quo Bias and Inertia

The status quo bias (a preference for keeping things as they are) and inertia mean that those organizations that have performance ratings are likely to retain them. Of course, we are all familiar with the status quo bias and inertia. We see it when college students sit in the same seat every day of the semester and when many of us never change the asset allocation in our 401(k) plans (Bazerman & Moore, 2009). And many people have signed up for the free-for-the-first-6-months magazine subscription, confident that they will cancel after 6 months (but they do not, so they are still subscribing and paying the regular subscription rate years later).

Sunk Costs

Of course, sunk costs (expenditures of money, time, and resources that cannot be recovered) should not affect our decision making. But evidence indicates that many people and organizations fall prey to the sunk cost fallacy. Most organizations have invested a lot in their current PM process. Managers have attended mandatory training sessions, and PM software has been purchased, implemented (more training for managers), and linked to performance increases. Decisionmakers are likely to feel that these investments have been wasted if the organization abandons performance ratings; therefore, decisionmakers will be less likely to abandon those ratings.

Following the Herd (Social Influence)

When a person visits a new city and sees a long line of people waiting to be seated at a restaurant, he or she often assumes that the food must be good and joins the line. Following the herd is also related to speculative booms and financial crises. Business organizations are no different, as reflected in the widespread practice of benchmarking. Most human resources (HR) organizations are influenced by the practices of other firms, and PM is no exception. Of course, for some business processes (e.g., logistics), benchmarking makes sense because there are objective metrics (e.g., time and cost to move a package from point A to point B) that can establish which firms are best in class for those practices. This is not the case for PM, where objective metrics of effectiveness are elusive at best. Still, most HR departments want to know what other firms are doing. Well-known consulting firms often report that the most admired companies have strong links between performance and rewards. In only a small minority of companies do all employees receive the same percentage pay increase. Most organizations rate results and behaviors, with over 90% of organizations providing an overall rating, most often on a 5-point rating scale (followed in prevalence by 4-point and 3-point scales; Hewitt Associates, 2010). Herding (social influence) will therefore drive many firms to retain their PM ratings.

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Risk Aversion

Related to herding, managers are often risk averse. As the expression goes, "No one ever got fired for buying IBM." It is likely also true that no one ever got fired for retaining performance ratings and linking them to pay increases.

In one organization (among the most highly regarded in its industry) where I recently consulted, the highest levels of management believed their organization's PM process was broken and needed a stronger developmental (and a weaker administrative) focus, with more emphasis on coaching and skill development and less emphasis on the administrative apparatus of performance ratings and their links to pay increases. A team of director-level managers from across the organization met for months and recommended that overall performance ratings be abandoned. Although some parts of HR were supportive, others (e.g., those who administered compensation) were resistant. In the end, a new organization-wide head of HR decided to "delay" making the change until sometime in the future, thereby effectively killing the initiative.

Loss Aversion

Abandoning performance ratings and their links to pay increases can seem to have little consequence if one takes a short-term view but not if one takes a longer term view. Consider an organization in which the difference between receiving a good performance rating (e.g., "solid" or "valued" employee) and receiving an excellent or exceptional rating is small (2% pay increase vs. 3% pay increase). Now consider two employees, each earning $50,000 per year. The difference between a 2% raise ($1,000) and a 3% raise ($1,500) is only $500, which is less than $10 per week (not even considering federal income and social security taxes). From this perspective, it is easy to say that abandoning ratings (and perhaps giving everyone the same percentage pay increase) should matter little to anyone. But now imagine that the first employee receives a 2% increase for 20 years and that the second employee receives a 3% increase for 20 years. After 20 years, the first employee's annual compensation will be $74,297, and the second employee's will be $90,305. Over those 20 years, the first employee will have earned $1,239,165, and the second will have earned $1,383,824, a difference of $144,658. To the exceptional employee, this difference can reasonably be considered a meaningful loss.

Moreover, even in organizations in which differences in performance ratings have no (or almost no) consequence for pay increases, abandoning the ratings will be seen as a loss by those employees who receive more favorable ratings and who are pleased that, at the least, someone noticed and recognized their higher level of contributions.

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Finally, according to equity theory, when people contribute more, they usually expect to have outcomes that are higher than the outcomes of those who contribute less. When this expectation is violated, it can affect turnover intentions and increase the risk the firm will lose its most valued employees. For all these reasons, loss aversion is likely to be a force in retaining performance ratings and their (albeit small) link to pay increases.

Final Thoughts

I want to emphasize that I am not arguing that performance ratings (and their links to pay increases) should or should not be retained. I agree with Pulakos et al. (2015) that there is no simple or broadly applicable answer to this decision. I am merely noting that a considerable body of research in psychology, behavioral economics, and decision making points to strong forces that are likely to make performance ratings a fact of life in most organizations for years to come.

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The Performance Management Fix Is In: How Practice Can Build on the Research

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The scientist–practitioner model of training in industrial and organizational psychology provides the foundation for the education of industrial and organizational psychologists across the world. This approach is important because, as industrial and organizational psychologists, we are responsible for both the creation and discovery of knowledge and the use or application

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