14. Redesigning a performance management system

Rebecca Campbell and Vida Amani

This case study sets out the redesign of the performance management system of a fictionalised company, Global Media Organisation (GMO). The case events are real, although the characters and organisational details have been disguised. Case A sets out GMO's old system which used a forced distribution model to rank employees into five categories. The head of human resources (HR), Kate Jones, is concerned that this system is demoralising, takes up a huge amount of time, undermines cooperation and does little to develop employees. The aim is to come up with a less time-consuming system that still recognises the best (and worst) performers. It also needs to be budget neutral. Case B sets out the company's proposed solution.

The teaching objectives are:

- to give students an understanding of the purposes of a performance management system
- to give students an insight into the challenges associated with designing a performance management system
- to evaluate the advantages and disadvantages of forced distribution
- to evaluate the tension between evaluative ('judge') versus developmental ('coach') approaches to performance management
- team outcomes.

Guidance on how to write a case analysis can be found in Chapter 1, 'Business cases: what are they, why do we use them and how should you go about doing a case analysis?'.

How to cite this book chapter:

Campbell, Rebecca and Amani, Vida (2025) 'Redesigning a performance management system', in: Sallai, Dorottya and Pepper, Alexander (ed) *Navigating the 21st Century Business World: Case Studies in Management*, London: LSE Press, pp. 193–201. https://doi.org/10.31389/lsepress.nbw.n

A teaching note for this case is available to bona fide educators. To request a copy please email r.m.campbell@lse.ac.uk

Introduction

GMO was a FTSE250 Media company with 6000 employees in the UK. Founded in 2001, in their last annual report they had reported revenue growth of over £900m, achieved between 2010 and 2023, mainly through acquiring smaller independent production companies.[1]

It was Spring 2023. Kate Jones, GMO head of HR, was reviewing their current performance management system. It should be so simple. Set performance targets, monitor their achievement and then communicate ratings and pay outcomes to employees. However, GMO's current system (Case A) took up huge amounts of time and seemed to leave everyone unhappy. Jones had been brought in to shake things up. She knew the current system was not working, the challenge was to come up with something better (Case B).

Case A: The old system

While business was going well, Jones was concerned that they had been losing key staff to similar sized local competitors and had recently had some difficulty attracting the right calibre of new employees. Jones was concerned that their current performance management system was too focused on judging past behaviour and was not doing enough to develop and coach employees going forward. She was also concerned about GMO's use of forced distribution and its effect on both employee and line manager morale. Forced distribution, famously championed by Jack Welch at General Electric, is where employees are ranked against their co-workers and put into fixed categories. For example, the UK Civil Service used to rank senior staff according to whether they were top performers (25 per cent) average performers (65 per cent) or underperformers (10 per cent).[2] This practice was designed to address the problem of lenient managers who prefer to avoid difficult conversations about poor performance. It is also a way to control costs. If you are going to link performance ratings to pay, then you have to have some way to ration out bonuses and pay rises. But forced distribution has many problems. It can be very rigid and often leads to gaming of the system. For example, managers can rotate the higher rankings between employees – so everyone gets a turn. Some employees may find themselves put into the bottom category, despite meeting objectives, just because someone has to be. Jones had heard some horror stories at her last job where some new joiners had automatically been put in the bottom classification as they were 'easier to sacrifice'. Forced distribution was also notoriously disruptive of teamwork if everyone was competing for the coveted top spots. In short, Jones was concerned that GMO's current performance management system was more about reviewing past performance than coaching for better future performance. She was also worried that the use of forced distribution was doing much to undermine the atmosphere of teamwork and collaboration that was central to GMO's success.

GMO's current performance management system

The ideal performance management system would encourage the types of behaviour required by management, provide an objective and accurate summary of employee achievements (which could be used to inform pay and bonus decisions), and be perceived as fair by employees. Put more formally, performance management is a 'continuous process of identifying, measuring, and developing the performance of individuals and teams and aligning performance with the strategic goals of the organisation'.[3] But what sounded easy on paper, was anything but.

Jones had done a back-of-the-envelope calculation and estimated that their current system was taking an average of 26 hours per employee over the course of the year. With 6000 employees this meant they were talking about a total of 156,000 hours. Many companies who had done similar calculations, were abandoning the annual appraisal entirely.

The process

In January, line managers met with employees to set objectives for the coming year. These were based on 'What and How'. The 'What' set out individual and team goals that were aligned with the organisation's strategic objectives, such as: project completion; meeting sales targets; audience targets or meeting sustainability goals. 'How' objectives were set around the organisation's values and behaviours, for example: working collaboratively with team members; positive 360 feedback results and taking on coaching and mentoring roles to develop the next generation. For a data and evidence-gathering exercise, this clearly would turn into a cumbersome part of a line manager's role.

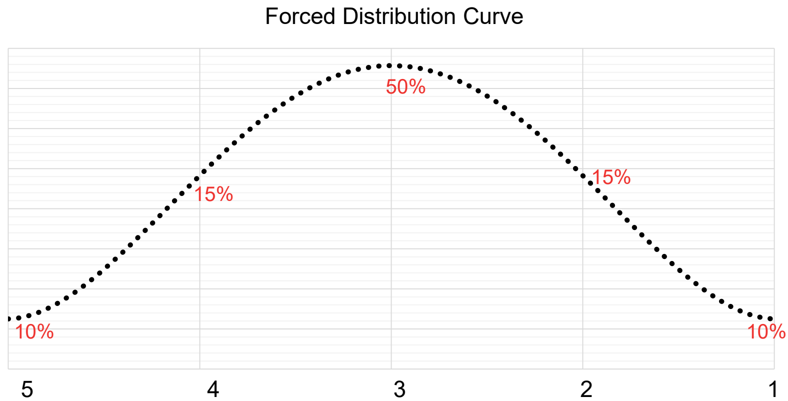
In October, calibration meetings were held between HR and line managers to discuss how employees had performed during the year. All employees were ranked, according to forced distribution, on a scale of 1–5, illustrated by Figure 14.1. This was strictly enforced on a departmental level and line managers prepared heavily for these meetings to defend their rating decisions.

- 1 = exceptional (exceeded all set objectives, went above and beyond what is expected and worked collaboratively in line with organisation's values and behaviours; only 10 per cent could get this rating)
- 2 = excellent (met all set objectives to a high standard, role-modelling organisation's values and behaviours; only 15 per cent could get this rating)

- 3 = met all objectives (met most set objectives, displayed organisation's values and behaviours; 50 per cent could get this rating)
- 4 = met partial objectives (missed set objectives and/or needs to work on 'ways of working'; 15 per cent got this rating)
- 5 = missed objectives (missed objectives and does not work in line with organisation's expected values and behaviours; 10 per cent got this rating).

Before the calibration meetings, managers prepared by identifying their top performers, at-target performers and bottom performers. At this stage, managers were not generally attempting to differentiate precisely. In the calibration meeting, a more fine-grained ranking took place. They would start by identifying the strongest performers by department, comparing peers in terms of impact and performance. The bottom performers were similarly identified and compared against peers. The remaining population in the middle were ranked accordingly. Comparing employees across the entire department meant a larger pool for comparison, which addressed the issue of managers with small teams where it could be very hard to fit employees into a forced distribution. Once all employees were rated, they were entered into a spreadsheet that ensured there was a smooth bell curve. Line managers and HR had to strictly adhere to the forced distribution. This process was both arduous and time consuming. Overall, the meetings were dreaded by everyone. The final part of the process happened in December. When ratings had been agreed between the line managers and HR, an end-of-year performance discussion was held between the individual employees and their line managers about their rating. These could potentially be very distressing conversa-

Figure 14.1: Forced distribution curve applied to GMO's performance ratings



Source: prepared by author. Note, this indicates how, a maximum of 10 per cent of employees could be awarded a rating of 1.

tions, particularly if a manager was delivering the news of a '4' or '5' rating. And the timing – just before Christmas – did not help. Those who received a '3' were often left feeling uninspired as nobody really likes to see themselves as 'average'. Even employees who received a '2' were often left disappointed. Despite it celebrating 'excellent' performance, getting a '2' for these employees felt like getting a 'B' grade instead of an 'A'.

The link between ratings and pay

These ratings were used to determine the employee's annual bonus and their annual pay increase.

Bonus

To give an example, suppose an employee had a salary of £50,000, and had a target bonus opportunity of 15 per cent of their salary, their target bonus would be £7500. This target bonus opportunity would then be adjusted by a multiplier depending on the employee's performance rating. If they had a rating of 1 (exceptional), a multiplier of 2 would be applied and they would get a bonus of £15,000. However, if they had a rating of 4 (met partial objectives), a multiplier of 0.5 would be applied and they would only get a bonus of £3750 (see Table 14.1).

The example shown in Table 14.1 is based on a target bonus opportunity of 15 per cent of a £50,000 salary.

Table 14.1: Bonus multiplier

Rating	Multiplier	Bonus Outcome
1 (exceptional)	× 2.0	£15,000
2 (excellent)	× 1.5	£11,250
3 (met all objectives)	× 1.0	£7500
4 (met partial objectives)	× 0.5	£3750
5 (missed objectives)	× 0.0	Nothing

Source: prepared by author

Annual salary increase

GMO also linked the annual salary increase in line with the rating, so the top performers would see their salary increase faster. The organisation would start by setting an overall salary increase budget. This was informed by factors such as cost of living, inflation and external market data. For example, the organisation might budget for a general salary increase of 2.5 per cent. However, managers would have some flexibility within their budget to award higher or lower increases. For example, if the overall budget was set to allow a

Table 14.2: Salary increase

Rating	Salary Multiplier
1 (exceptional)	5% increase
2 (excellent)	3.5% increase
3 (met all objectives)	2.5% increase
4 (met partial objectives)	1.0% increase
5 (missed objectives)	No increase

Source: prepared by author

2.5 per cent salary increase, then those who got a higher performance rating would get a higher increase, and those who got a lower rating would get a lower (or no) salary increase (see Table 14.2).

The result in terms of morale?

What typically happened was that unless employees were in the top 10 per cent, getting a rating of 1, the end-of-year conversation between the line manager and employee was not going to be a good one.

- Those who got a '2 – excellent' felt like they got a 'B' grade, so this led to lower engagement.
- Those who got a '3 – met objectives' felt like they got a 'C', typically 'coasted along' and were not in a mindset to exert discretionary effort.
- The '4' and '5' rating employees usually felt anxious and fearful.
- The managers were exhausted!
- HR knew that the performance dialogues were mainly focused on reward consequences, less on development.

What to do?

Jones sighed. As far as she could see GMO was spending a huge amount of time and money on this process, and the end result was that no one was happy. It was very time consuming (and so expensive) for line managers and HR to administer. Managers hated the forced distribution model as it meant that most employees (even those who were doing really well) were unhappy at the end of the cycle. Employees hated it because it felt subjective and secretive. Business leaders were questioning what was the return on investment of the process if performance and engagement did not increase with higher ratings?

It was easy to see that the current system was not working, what was harder was to come up with a better solution.

Preparing the case (A)

In preparing the case analysis, and before reading Case B, you might like to consider the following questions:

1. What are the advantages and disadvantages of GMO's old performance management system?
2. Why do you think GMO used forced distribution in the first place?
3. What do you think of the tension between the 'coach' and 'judge' aspects of performance management. Why might it be hard to do both well?
4. Should GMO get rid of performance management entirely?
5. Come up with an alternative performance management system for GMO.

Case B: the proposed new system

On Jones' advice, GMO got rid of the five-level rating system altogether. It was expensive, time consuming and was failing in its primary objective – to increase motivation and engagement.

The proposed new system

Bonus

Everyone was granted their target bonus opportunity based on business (not individual) performance. The rationale behind this was to encourage a 'one team collective culture of winning and losing together'. For example, an employee on £50,000 would still have a target bonus of 15 per cent – i.e. £7500. But this target bonus would be pegged to the business hitting its targets (for example annual revenue targets, product launch targets, environmental and sustainability targets). If the business exceeded its targets, then the 15 per cent bonus would be adjusted up. But if the business missed its targets, then the bonus opportunity would be adjusted down.

And what about the outliers? Jones wanted GMO to get rid of the exhausting and demoralising forced ranking system, but she still felt that the organisation needed to distinguish the very highest (and lowest) performers. Her solution was to create a CEO 'Impact Award' for the star performers. As she said to her assistant, 'let's face it, we all know who they are'. This award included both cash and share elements. So, on top of the bonus based on business performance, they would also get a cash award plus shares. Shares were introduced to incentivise long-term retention for key talent in the business.

For example, if you were on £50,000, and got the 'Impact Award', then your total bonus would be:

- £50K × 15% = £7500 (bonus based on business performance)
- plus, the CEO Impact Award cash top up of £5500 and £2500 in shares (notice broadly the same spend).

Although Jones was uncomfortable with using forced distribution, for budgetary reasons she still felt they needed a cap on the number of employees who could receive this award. She knew that if they did not have some constraint too many managers would say that they had employees who should receive the CEO Impact Award.

The underperformers (and again typically it was clear who they were) received no bonus and were put on performance improvement plans. After some discussion they again decided that there should be a (strict) target of 10 per cent that were expected to be in this category. They wanted a culture that was prepared to address underperformance directly and bravely and were concerned that without a firm target that managers would start slipping into bad habits.

Salary increases

Salary was increased using a similar method to the previous model. As before, the organisation set its salary increase budget and agreed a standard increase that was awarded to most employees. However, under the new system it was only the top performers (recipients of the CEO Impact Award) who would receive more and only the very bottom performers who received no increase.

From 'judge' to 'coach'

And what to do with all the time this freed up? Jones proposed that instead of dramatic end-of-year meetings, they introduce monthly high-quality employee/line manager 'dialogues' on development, areas of improvement and a celebration of achievements. The idea was to support the employee and give them a chance to 'course correct' as they go through the performance year.

The result?

Jones knew that what she proposed was not without flaws – no performance management system was ever going to be perfect. But she was happy that the proposed new system was a huge improvement on what had gone before.

Preparing the case (B)

After reading Case B you might like to consider the following question:

- What might be the potential problems with GMO's new system?

Further reading

Aguinis, H., (2009) 'An expanded view of performance management', in Smither, J. W. and London, M. (eds) *Performance Management: Putting Research Into Action*, Hoboken, NJ: Jossey-Bass/Wiley, pp.1–43.

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References

[1] GMO is a fictional company, described for the purposes of the case study. The case is based on the real-life experience of the writers.

[2] O'Connor, S. (2021) 'Why ranking employees by performance backfires', *Financial Times*, 6 April. https://www.ft.com/content/0691002c-2200-4583-88c9-9c942d534228

[3] Aguinis, H. (2009) 'An expanded view of performance management', in Smither, J. W. and London, M. (eds) *Performance Management: Putting Research Into Action*, Hoboken, NJ: Jossey-Bass/Wiley, pp.1–43.