Finding 1: Research in 2004 indicates that approximately one-third of organizations use competency-based performance management systems; this represents a significant decline, however, from 48 percent of organizations in 2001. Companies incorporate both objectives and competencies (company-wide and/or job-specific) into aspects of performance management.

- Research suggests that there may be a move away from the competency approach to performance management. Mercer HR Consulting’s 2004/2005 U.S. Compensation Planning Survey indicates that 36 percent of companies use a competency-based performance management system, while 16 percent are considering the use. These numbers do reflect a slight increase from the 2003/2004 survey which reported 34 percent of companies using the system with 18 percent considering it. However, this is a significant decline from a 2001 Arthur Andersen study finding that 48 percent of participating organizations used competency-based performance management systems.1,2,3

- Council research indicates that five of six profiled companies use competencies in performance management systems. However, these companies vary in the employee groups to which they apply competencies. Three profiled companies incorporate competencies for all employees, while one uses them for only exempt employees and another for just HR employees.4

- In 2003 Council research examining executive-level performance management, four of six profiled companies formally maintain mastery of specific competencies, values, or behaviors as performance criteria. However, companies typically assign competencies less importance than the achievement of objectives.5

- Use of company-wide competencies in performance management—The Minnesota Department of Transportation outlines seven “core competencies” expected of each individual and derived by integrating the organization’s mission, vision, and values; these seven core competencies serve as the basis for the performance management system. Instead of defining each of the seven terms, the department describes the behavior one would expect to see from a “true master performer” of each competency and rates an individual’s performance according to how often he or she performs as a master would in each area.6

- Use of both personal objectives and competencies in performance management—Allied Dunbar, a branch of Zurich Financial Services, relies heavily on competency assessment in its performance management system. Major components of the system include the following two sets of guidelines:7
  - **Personal objectives**—individualized guidelines for each employee based on past performance and linked to corporate objectives, strategies, and tactics.
  - **Competencies**—tailored to each position, listing skills and abilities employees in each position must demonstrate.
Finding 2: Incorporating competencies into performance management processes allows companies to emphasize the importance of competencies, expand performance considerations, ensure adequate rewards for performance, and connect performance management to other talent management processes. That said, companies may face difficulty as competencies are quantified less easily than objectives.

Advantages of Including Competencies in Performance Management

- **Emphasize importance of competencies**—The integration of competencies into performance appraisals allows companies to align employees’ job performance with the organization’s goals. Furthermore, this integration helps companies to identify and reinforce behaviors that lead to exceptional performance rather than evaluate behaviors required for average performance. According to Dick Grote, a performance management consultant and author, “the appraisal system can guarantee that these competencies are fully understood and institutionalized.”

- **Expand performance considerations to yield a true picture of performance**—According to Tracey Weiss, a consultant and author, one of the six characteristics fundamental to all performance management systems is that performance measures include quantifiable objectives and behavioral competencies. Companies previously used numeric results such as market share and revenue, while recently they increasingly include non-numeric measures. By using competencies along with personal objectives or performance targets, employers can measure how staff carry out their work in addition to considering what they produce.

- **Ensure adequate rewards for performance**—Whereas an incentive system encourages outputs, a competency system encourages inputs. When external conditions negatively affect results, an incentive-based system cannot reward the superior performers. Likewise, a strong economy may produce growth that is not necessarily linked to truly outstanding performance. In a competency-based system, companies can retain and motivate superior performers despite the impact of external conditions.

- **Connect performance management with other talent management processes**—With a competency-based performance management system, the organization delineates the performance criteria for each level so that employees know what competencies they must master in order to advance. Companies will be able to manage their talent pool more easily, perform succession planning, and build bench strength for the future. In addition, it creates a basis for recognition and reward, merit increases, and promotions.

Challenges of Including Competencies in Performance Management

- **Competencies are quantified less easily than objectives**—Assessing competencies accurately can prove difficult as, unlike objectives based on an individual’s financial contribution to the company, they are quantified less easily. However, 360-degree reviews can address this problem by providing multiple sources of data.

- **Difficulty in implementing the new competency-based system**—Overall, companies in past Council research reported few problems implementing the competency methodologies across the organization. However, challenges encountered include the following:
  - Agreeing on the weight and relevance of a competency to a particular business environment
  - Clarifying that competencies describe people’s action and not necessarily jobs
  - Determining and defining a process for assessing individuals against model
  - Explaining to employees why the company changed and how the competencies are different from or similar to any other processes
Finding 3: Companies often consider development planning to be a part of the performance management process, with development plans often following performance reviews. Linking performance management, succession management, and individual development planning can avoid redundancies. However, some companies separate development planning from performance reviews to preserve data integrity and honesty as these processes have different emphases.

Including Development Planning in Performance Management

- In a 2002 Council survey of 147 members, 92.5 percent of respondents indicated using individual development plans as a performance management practice. Similarly, companies profiled in past Council research typically include an individual development component to the performance review process as an area on review forms. In addition, the high-tech company Compaq indicates conducting formalized development planning once annually in conjunction with the performance review cycle.17,18,19

- While many companies maintain processes for performance management, succession planning, and individual development, many fail to link these processes, resulting in redundancy, preventing the transfer of knowledge, and failing to ensure that individual development needs are addressed.20

- Integrating career development with performance and succession management creates a seamless process for stakeholders. At a profiled auto manufacturing company, management views career development as working with succession planning and performance management to improve employee development and advance the organization’s capabilities, as illustrated below.21

A retail company profiled in 2002 Council research indicates that the annual review process comprises the following steps, cumulating in a development plan based on the performance review:22

- **Feedback From a Variety of Sources**
  Employee requests feedback from a variety of sources, including clients, team members, and peers.

- **Self-Assessment**
  Employee performs a self-assessment and submits this document to the manager.

- **Formal Appraisal**
  Manager writes formal appraisal of employee, utilizing feedback from various sources and employee’s self-appraisal.

- **Manager-Employee Meeting**
  Manager reviews appraisal with employee, allowing employee the opportunity to add comments to the review form. Manager provides a rating of the employee’s potential.

- **Contract for Results and IDP Drafted**
  Upon reviewing recent performance, the manager and employee draft a Contract for Results and an individual development plan (IDP). This Contract serves as the basis for next year’s performance appraisal, as it defines the competencies by which the employee will be assessed and the development actions the employee hopes to achieve.

© 2004 Corporate Executive Board
Finding 3: continued

Separating Development Planning from Performance Management

- While many development discussions are based on results of performance reviews, some companies use separate processes for performance ratings and employee development, as these processes have different emphases. Council research profiles a retail company that uses a Productivity Improvement Review for employee development and Standard Performance Reviews for performance ratings. While the former examines employee performance from a developmental and promotion standpoint, the latter provides a more quantitative rating of employee performance. The Standard Performance Review occurs immediately after the Productivity Improvement Review.23

- An auto manufacturing company profiled in past Council research notes that employee performance reviews do not include achievement of competency gains targeted by individual development plans. The interviewed individual expressed concern that linking career development to performance management processes threatens the data integrity and honesty.24

- Caterpillar, Incorporated includes development planning as a part of the performance management process, yet the development plan occurs at a different time from the performance evaluation, as follows:25

  - Performance Planning (January & February)
  - Upward Feedback to supervisors (May & June)
  - Development Planning (August & September)
  - Performance Summary (December & January)
  - Pay Determination (February & March of the following year)
4 Corporate Leadership Council, Use of Competencies within the HR Function, Washington: Corporate Executive Board (October 2002).
8 Corporate Leadership Council, Competencies and Performance Management.
11 Incomes Data Services, "Competency Frameworks," IDS Studies (April 2001). (Due to copyright restrictions, we are unable to provide a copy of this research.)
15 Corporate Leadership Council, Executive Level Performance Management.
16 Corporate Leadership Council, Use of Competencies within the HR Function.
21 Corporate Leadership Council, Implementing Career Development Initiatives, Washington: Corporate Executive Board (June 2003).
22 Corporate Leadership Council, Supporting Employee Development through Performance Management.
23 Corporate Leadership Council, Supporting Employee Development through Performance Management.
24 Corporate Leadership Council, Implementing Career Development Initiatives.
25 Author Unknown, "Individual Development Plans."

© 2004 Corporate Executive Board