IN FOCUS ▪ This article examines the fundamental role of human processes (behavioral algorithms) in driving sustainable profitability in knowledge-based organizations. In particular, it describes the practical challenges, common pitfalls and requirements for an effective individual performance feedback algorithm as a cornerstone of enterprise value growth.

Rigorous Performance Feedback:
A Slippery Cornerstone of Enterprise Value Growth

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Humα**tica**

The future has already arrived, it's just unevenly distributed.

Alvin Toffler, the famous American futurist wrote in his bestseller Future Shock: *"The illiterate of the 21st century will not be those who cannot read and write, but those who cannot learn, unlearn, and re-learn."* The same advice applies just as well to corporations and public organizations today. Life is not getting any easier for them in the new millennium. Dramatic and fundamental forces like the collapse of information cost, market liberalization and new technology are shifting the competitive chessboard faster than ever before in most industries. The old rules linking profitability to market share through lower unit cost are increasingly no longer valid. Instead, the only constant in the enterprise value equation is adaptive change. And this new reality has far reaching implications for organizations, employees and the people that must either adapt or exit - a new frontier for leaders, and the led, alike.

Corporations are struggling to cope with the new order. Many are already competing in the future, but with organizations and leadership processes still rooted in their industrialist past. Darwinian market forces of natural selection are shaping change - allowing firms that "get-it" to survive, and punishing others whose organizations evolve more slowly.

But why aren't more firms moving faster to pro-actively align their organizational processes for future success?

One reason is that it is unclear what "getting-it" means. Knowledge workers are a subjective and volatile resource whose productivity is difficult to measure. The links between actionable changes and better corporate performance are loose at best. Never the less, there are some basic relationships which are emerging.

Leadership plays an essential role in knowledge organization productivity. Egon Zehnder's management journal recently devoted an entire edition to managing this complexity. In it, Daniel Meiland, the firm's chairman acknowledges that "stability, continuity predictability and clarity – the foundations of conventional corporate leadership – all vanish in complex settings". Egon Zehnder's conclusion, along with that of most corporations facing this new knowledge-based competitive environment, is increased faith in the senior leader as the guiding light, from which a superior corporate cultural and values will be projected and which employees will (hopefully) follow. This conventional wisdom in the face of increased complexity certainly explains the rapid increase in senior executive pay. However, like most over-simplifications, this is only partially correct.

"Knowledge management", another attempt to better manage in an increasingly complex business environment, also misses the mark. Measures of raw individual intellect, like IQ tests, require subjects to find patterns in data. The same definition of knowledge applies equally well to corporations. Early recognition of shifting business patterns – demand, technology, competition, obsolescence – and adaptation are increasingly the underlying drivers of sustained success. However, in practice, knowledge management did not address these critical aspects. It has remained an ill-defined, academic exercise, confined to the realm of "special projects" that deliver little in terms of concrete results.

Clearly, corporate leaders and organizations are still groping for practical ways to better manage knowledge-based organizational systems.

„Systems Engineering" the Organization

Perhaps they can learn from some of the most complex technical systems which have been mastered in the 20th century. Like micro-processors, organizations have inputs and outputs. Their job is to most efficiently maximize the desired outputs (products, services, profit, sales growth) in the face of shifting inputs (technology, customers, needs, preferences, finances). The inputs to organizational systems have become more turbulent in recent times, and the required stability of outputs more stringent, as any company who misses analyst expectations can attest. During the industrial age, the corporate systems' core asset was a capital platform, such as a factory or branch network. These are linear assets whose output grows steadily with expanding scale. However today's core asset is knowledge workers, whose productivity varies widely depending on subtle factors that influence motivation. And, unlike physical infrastructure, people are a mobile asset which the company does not own. It's therefore no surprise that leaders and employees alike are frustrated as they learn to manage within these new realities.

The easiest way to control a complex system is to install complex controls. Faced with increasingly intelligent workers, many firms create more policies, rules, regulations and standards to control them. ISO certification and Sarbanes-Oxley requirements are just two manifestations of these rule-based controls. However, according to A.G. Lafley, the CEO of Proctor & Gamble, "if you try to match complexity with complexity, it will kill the organization." Fundamentally new ways of managing the company's non-linear, people asset are needed in order to master the new business challenge. Here too, useful lessons can be learnt from complex technical systems.
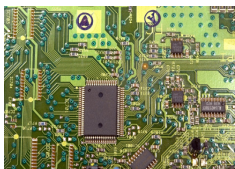
Large microprocessors and complex computer programs are actually made-up of simple, small standardized modules – gates and sub-routines respectively. Organizations are similar. They are a collection of human subroutines. The way people communicate with one another, their behavior, the way decisions are made and the way they are implemented characterize an organization and its corporate culture. These subroutines or Human Algorithms™ define the efficiency and performance of complex organizations. They determine how well an organization can act on information and adapt to changes in its environment. However they are not subject to standards. Even simple human algorithms, like the hiring process, differ greatly between corporations. And some

algorithms are clearly better than others in knowledge-based companies.

As business environment inputs become more turbulent, the key resource shifts to non-linear knowledge workers and output performance requirements become more demanding, the individual performance feedback algorithm becomes a critical subroutine to optimize the corporate system's performance. Human performance measurement was simpler in the past when most employees were manual laborers. A stop-watch and Frederick Taylor's Principles of Scientific Management were sufficient to optimize productivity. However now, with over 80% of workers in service industries, people have become the product and the quality (not just quantity) of interactions is critical. Despite this shift, the performance feedback algorithms of most companies are still stuck in the grip of their industrial past.

Herding cats

Knowledge workers are independent. Their behavior is more like

a cat's than like that of herdable cows. Managing talented people, especially the top performers, is therefore a unique challenge. Employee performance measurement and feedback is one of the few tools available for directly aligning individual behavior with the interests of the organization and its shareholders. It is a critical process for systematically developing and selecting talent. Finally, it is also important for shaping a performance culture and optimizing team output throughout the business cycle. Despite these advantages, few companies have performance measurement and feedback processes which instill trust and are rigorous enough to be truly effective.

Part of the problem is that individual performance is inherently difficult to measure, especially for knowledge workers. Unlike repetitive tasks, the unit output of knowledge workers is not easily quantified. In the extreme example, an overly complex system which counts "good ideas" from an engineer could easily generate thousands of ideas which add cost, confusion and no value – exactly the behavior NOT desired.

The subjective nature of knowledge worker performance criteria, such as communication or logical thinking, also presents an inherent challenge. It creates difficulties in defining an objective, fact-based assessment of employee performance. Is someone outgoing, or arrogant? The answer depends greatly on your own personality. And, if the definition of performance is not clear, then reviewees and reviewers spend more time trying to develop a common understanding of definitions than objectively discussing performance and development.

Reviews also don't work because humans are by nature a collaborative species and therefore generally avoid conflict.

And, no matter how constructive, criticism is usually associated with conflict. This is compounded when the person delivering feedback is also responsible for making the judgment, as is normally the case. Different cultures tolerate different levels of conflict in the workplace. Generally tolerance is low in Asia and Europe where consensus is most highly valued. However, avoiding an open and fact-based discussion on individual performance leads to a sclerotic organization, incapable of self-criticism and change, no matter where you are on the globe.

Finally, performance feedback is an area rife with dysfunctional employee behavior that destroys trust between leaders, and the led. The understandable wish to protect confidentiality often provides enough in-transparency to allow individual power abuse. Intelligent people will often use this for their personal benefit at the expense of the organization and shareholders. For example, how can the company insure that excellent employees are not kept down by insecure supervisors? Or the opposite, which is more common: supervisors pushing under-qualified employees based on personal relationships or other dysfunctional factors not aligned with shareholder interests.

360° reviews have become popular in the recent past to overcome some of the assessment challenges posed by complex, networked knowledge organizations. However, they are not the solution. When done anonymously, they can degenerate into systematic mobbing. And if done transparently, one must question the relevance of upward feedback on the most critical leadership and experienced-based skills.

In order to be effective, individual performance feedback must avoid all of these pitfalls. The review process must be transparent. It must therefore involve most employees, not only as reviewees, but also as reviewers. Critical cross-checks must be built into the feedback algorithm in order to prevent power abuses and increase transparency. At the same time, it must protect the confidential nature of each employee's individual performance and prevent dysfunctional peer-to-peer competition. The process must insure that reviewees are qualified to pass judgment on specific performance dimensions. And finally, organizations must break through their fear and anxiety about constructively addressing performance issues on a regular basis. All this requires forethought, a refined human algorithm, training and practice.

However, the benefits of an excellent review process go beyond motivating and aligning the efforts of current employees. Increasingly, companies will have to provide professional growth opportunities in order to attract talent. The performance feedback human algorithm can be an important tool for balancing employee's longer-term needs for personal development with the increasing financial demands of shareholders.

As profits become more dependent on the knowledge resources in a company, leaders will have to fundamentally re-think their employee performance measurement and feedback systems. Trustworthy, individual performance feedback will become an increasingly critical human algorithm to measure performance and align individual efforts with company objectives. Stable, self-sustaining feedback processes are difficult to establish because of the subjective and volatile nature of individual human interactions. However, once established, a refined feedback algorithm becomes a critical tool to allow the organization to "learn, unlearn and relearn" in Toffler's words, and thereby generate superior value for its shareholders in the 21st century.

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