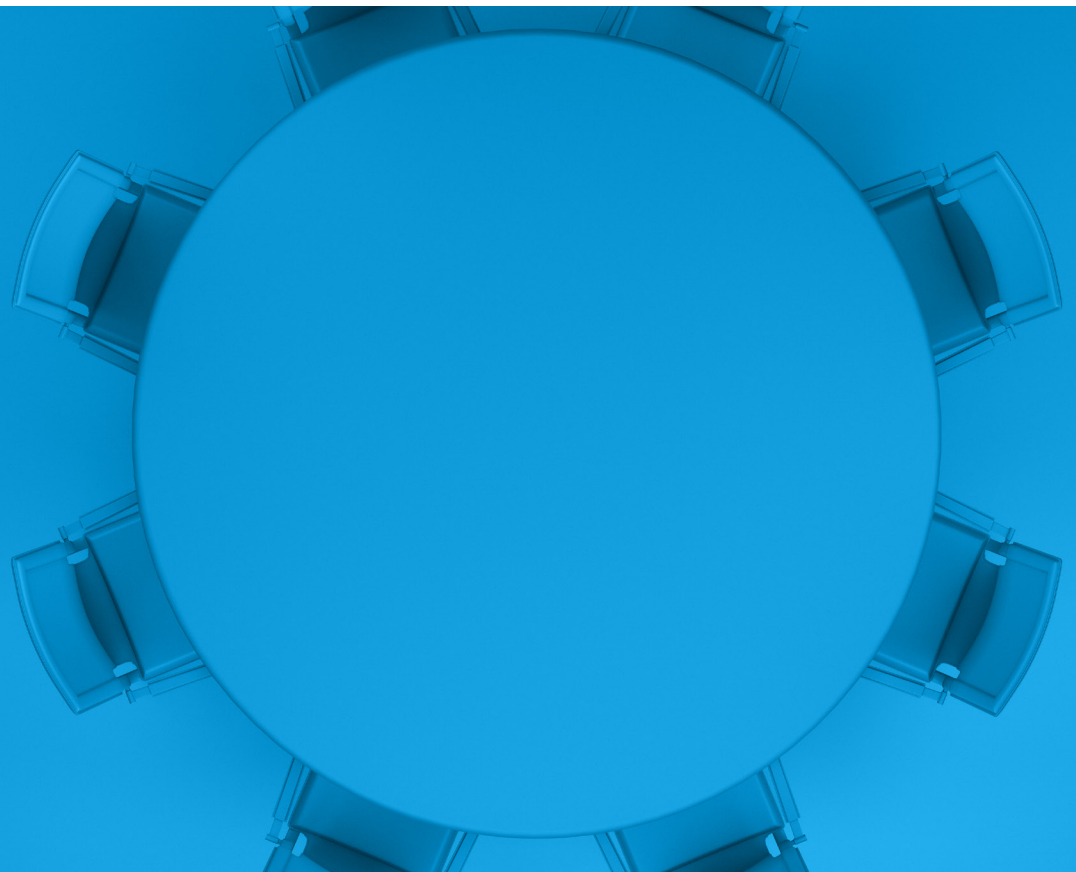


Organization Practice

Performance management in agile organizations

Performance management is tough enough in traditional organizations; in agile organizations, three changes are essential to success.

by Lucia Darino, Marcus Sieberer, Arthur Vos, and Owain Williams



The evidence is clear: a small number of priority practices make the difference between an effective and fair performance-management approach and one that falls short. Organizations that link employee goals to business priorities, invest in managers' capabilities, and differentiate rewards for the extremes of performance are 84 percent more likely to have performance-management approaches that their employees perceive and recognize as being fair. Furthermore, these practices are mutually reinforcing: implementing one practice well can have a positive effect on the performance of others, which leads to positive impact on employee and organizational performance, which, in turn, drives organizations to outperform peers.

But how do these priority practices work in the context of agile organizations, which feature networks of empowered teams and rely on a

dynamic people model? Colleagues rightfully ask a number of related questions:

- Why do I need individual goals when the locus of organizational performance is my squad, chapter, and tribe?
- Who will coach and evaluate me when I have no boss? How can my evaluator understand my performance when he or she doesn't see my work day to day?
- How can we maintain a team spirit while still fairly differentiating the highest- and lowest-performing colleagues?

The good news is that there are answers to these questions—and, going further, agility can be a springboard to improve performance-management practices that traditional organizations struggle with

What defines an agile organization

“Traditional” organizations, designed primarily for stability, involve a static, siloed, structural hierarchy. Goals and decision rights flow downward, with the most powerful governance bodies at the top. These organizations operate through linear planning and control to capture value for shareholders. Although such a structure can be strong, it is often rigid and slow moving.

In contrast, agile organizations are designed for both stability and dynamism. They are made up of a network of teams within a people-centered culture that features rapid learning and fast decision cycles enabled by technology and guided by a

powerful common purpose to cocreate value for all stakeholders. Such agile operating models allow for quick and efficient reconfigurations of strategy, structure, processes, people, and technology toward value-creating and -protecting opportunities. Agile organizations thus add velocity and adaptability to stability, creating a critical source of competitive advantage in volatile, uncertain, complex, and ambiguous (VUCA) conditions.

Five trademarks distinguish these organizations:

- a North Star embodied across the organization

- a network of empowered teams
- rapid decision and learning cycles
- a dynamic people model that ignites passion
- next-generation-enabling technology

For more, see “The five trademarks of agile organizations,” January 2018, on McKinsey.com.

(Exhibit 1). Nearly all organizations, for example, feel the need for more frequent feedback. Working in agile sprints of a few weeks each creates a cadence into which collective and individual feedback naturally fits. Similarly, a culture of more autonomy and risk taking opens opportunities for employees to stretch, take on more responsibility, and find out quickly how they can improve.

Agile organizations will, however, need to adapt each of three core performance-management practices to make the recommendations actionable in the agile operating model (Exhibit 2).

Linking goals to business priorities

Transparently linking employees' goals to business priorities and maintaining a strong element of flexibility are core practices of agile ways of working. They are also significant practices if employees are





to have a sense of meaning and purpose in their work. But agile organizations may worry about how the emphasis on individual goals marries with the autonomous teams that characterize agility. There are three approaches that can help agile organizations to adapt and ensure that goals remain meaningful and linked to business priorities.

Introduce team objectives in addition to (or instead of) individual targets

Empowered and autonomous teams are central to agility. It therefore makes little sense to manage performance solely—or even primarily—on an individual level. Successful agile organizations focus on team performance when setting goals and evaluating performance, often allowing teams to define their own goals to drive ownership. At one bank, for example, performance objectives are a combination of team goals, individual contributions to the team, mastery of competencies required


Exhibit 1

The five trademarks of agile organizations have profound relevance for performance management.

Trademark	Changes affecting traditional performance management
 <p>North Star embodied across the organization</p>	<p>Leadership sets broad direction and priorities, against which teams define their own objectives, iterating at pace</p>
 <p>Network of empowered teams</p>	<p>Flat organizational structure with limited hierarchy and no middle management</p> <p>Empowered and autonomous teams, with end-to-end accountability and clear purpose</p>
 <p>Rapid decision and learning cycles</p>	<p>Risk taking, failing, and learning fast are encouraged</p> <p>Continuous people development aimed at improving the level of performance</p>
 <p>Dynamic people model that ignites passion</p>	<p>Culture that empowers the agile way of working</p> <p>Craftsmanship (ie, development of expertise) as a cornerstone</p>
 <p>Next-generation enabling technology</p>	<p>Performance management isn't materially different just because of enabling tech</p>

Source: McKinsey analysis

Adapting three core performance-management practices will be crucial.

Performance-management practice	What agile organizations may want to do
 Linking goals to business priorities	<p>Introduce team objectives in addition to (or instead of) individual targets</p> <p>Set objectives as a team, discuss results frequently, pivot as required</p> <p>Create transparency of targets and performance</p>
 Investing in managers' coaching skills	<p>Clarify the roles that leaders play in development and evaluation</p> <p>Focus on continuous feedback and ongoing development conversations</p> <p>Frequently collect input from multiple sources when evaluating performance</p>
 Differentiating consequences	<p>Differentiate individual contribution to team performance based on desired values, mind-sets, and behaviors</p> <p>Increase the emphasis on intrinsic motivation and nonmonetary rewards</p>

Source: McKinsey analysis

at the level of individual jobs, and alignment of professional behavior to the bank's values. The weighting of these components varies by role, with specialists, in particular, more inclined toward team performance to encourage collaboration. Another financial institution experimented with replacing individual objectives in contact centers with team objectives. Within a few months, it saw productivity gains of more than 10 percent, compared with control-group centers, in addition to a noticeable increase in teamwork and cohesion.

Set objectives as a team, discuss results frequently, and pivot as required

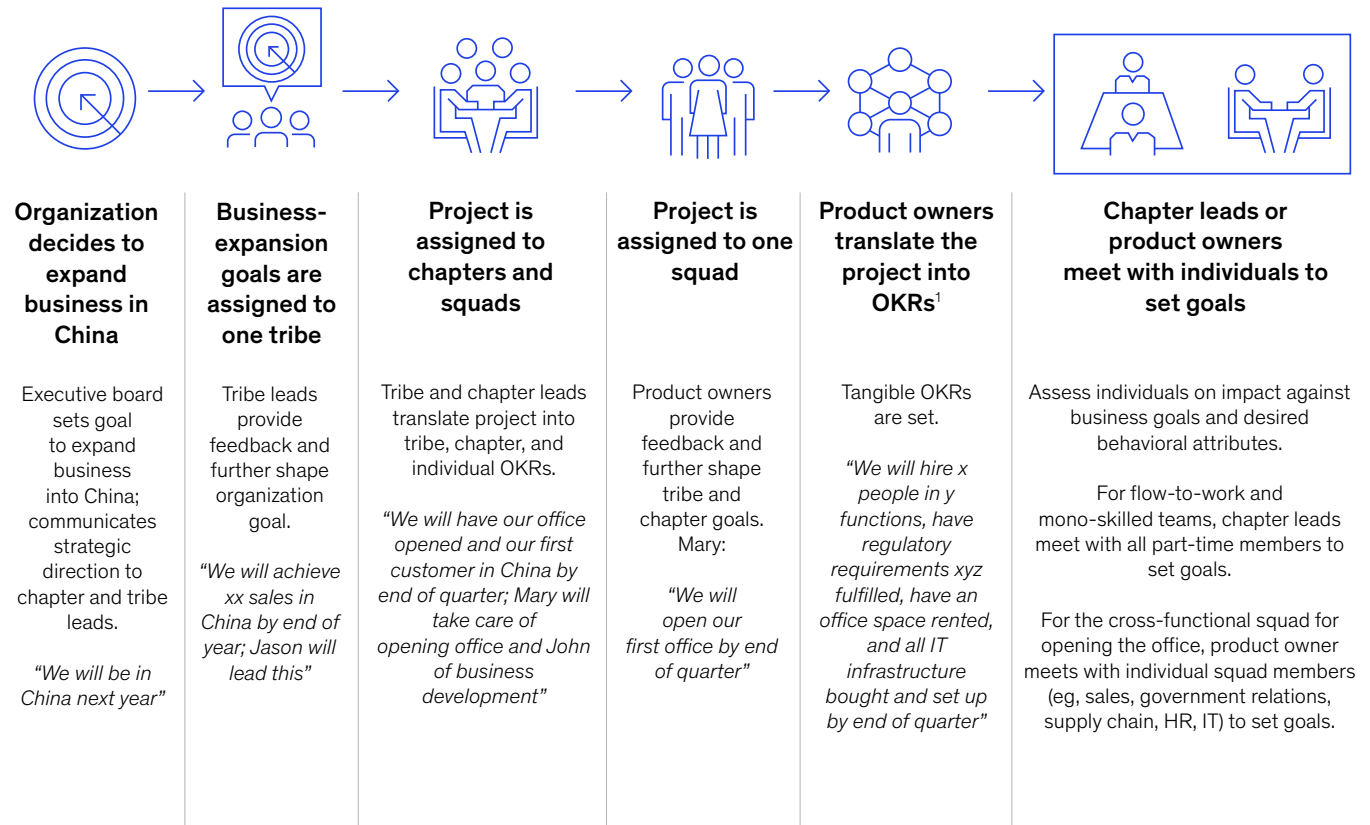
Teams in agile organizations work autonomously and at pace, with a clear focus on output. They follow broadly set directions and strategic priorities rather than detailed, top-down instructions (Exhibit 3). Agile organizations typically rely on a tightly run process—often a quarterly business review (QBR)—to ensure alignment among the autonomous teams.

This is where objectives and key results (OKRs), popularized at Intel in the 1970s and now used in many organizations, from the Bill & Melinda Gates Foundation to Google, come in. Every quarter, a clear cascade from strategic priorities to objectives at the team level is created, while performance versus key results is made transparent and discussed. To allow for changing priorities coming out of the QBR, team and individual objectives need to be dynamic, rather than fixed in a once-a-year exercise. Setting objectives collectively can have other benefits, too, particularly with regard to engagement and ambition. Unsurprisingly, commitment to goals that you have set for yourself is typically stronger than to those set for you by others. At a B2B sales organization, shifting to bottom-up goal setting (versus top-down setting by executives) resulted in 20 percent higher overall targets.

Create transparency of targets and performance

The decentralized nature of agile organizations

Agile organizations need to adapt their goal-setting approach.



¹ Objectives and Key Results.
Source: McKinsey analysis

creates a risk that devolution and empowerment might drift into chaos. One way to avoid this is to introduce extreme transparency of objectives and performance. At Google, all OKRs, starting with the CEO's, are visible to all other employees. At LinkedIn, the CEO's executive team reviews OKRs weekly. This kind of transparency also has several benefits: surfacing interdependencies among teams and units, creating urgency and "mindshare," and reinforcing the nonhierarchical culture and mind-set that characterize truly agile organizations.

Investing in the coaching skills of managers

Our prior research shows that managers—typically, line managers—are important stewards of effective performance management. Investing in their coaching skills to help them become better arbiters of day-to-day fairness is often the most powerful intervention in performance-management transformations. The agile organization, however, challenges the traditional model of the line manager. Who, then, acts as the day-to-day arbiter of fairness? And whose capability needs to be built? Agile

organizations can address these questions through three approaches.

Clarify the roles that leaders play in development and evaluation

In a prior publication, we described three different types of managers in agile organizations. In the context of performance management, each performs different roles. Chapter leaders evaluate, promote, coach, and develop their people. Tribe leaders set directions linked to business priorities, match the right people to opportunities or squads, coach their teams on how to enable collaboration across organizational boundaries, and empower people. Squad leaders strive to maintain a cohesive team by inspiring, coaching, and providing feedback to everyone. The common theme across these leaders is active coaching for ongoing development and arbitration of day-to-day fairness.

Focus on continuous feedback and ongoing development conversations

As in any organization, individuals in agile organizations develop through receiving feedback and being exposed to development opportunities. In successful agile organizations, feedback is the heartbeat in a culture of taking risks, failing fast, and pursuing continuous personal development at all levels. These organizations encourage employees to ask for and give feedback constantly. Making this happen is often hard. Managers and nonmanagers alike may need to overcome mind-set and capability barriers to giving and receiving feedback more frequently—not just up and down the hierarchy, but also to peers. A European financial institution, for example, invested in dedicated capability building for teams on how to have courageous conversations in a peer-like way.

Frequently collect input from multiple sources when evaluating performance

Agile organizations need disciplined rituals for continuously gathering feedback and evaluating performance (Exhibit 4). The line manager has

traditionally been the conduit for all information about the employee. But without the line manager, who acts for the employee? This requires a single person to gather feedback on an individual from several sources, synthesizing it, and working with other peers to make sure that evidence and decisions are calibrated. At a telco, for example, a chapter lead¹ evaluates the development of an individual within the chapter, gathering and synthesizing input from the product owners, team members, and agile coaches that the individual has worked with. The chapter lead then presents the individual's case to a people-review board made up of chapter leads. The board makes a collective performance decision and provides advice to the individual on how to develop further, which is then relayed by the chapter lead. Technology can help here. A leading e-commerce player developed an app for its employees that facilitates feedback and allows employees to share feedback with others after every interaction, the aim being for each employee to collect more than 200 feedback points during the year.

Differentiating consequences

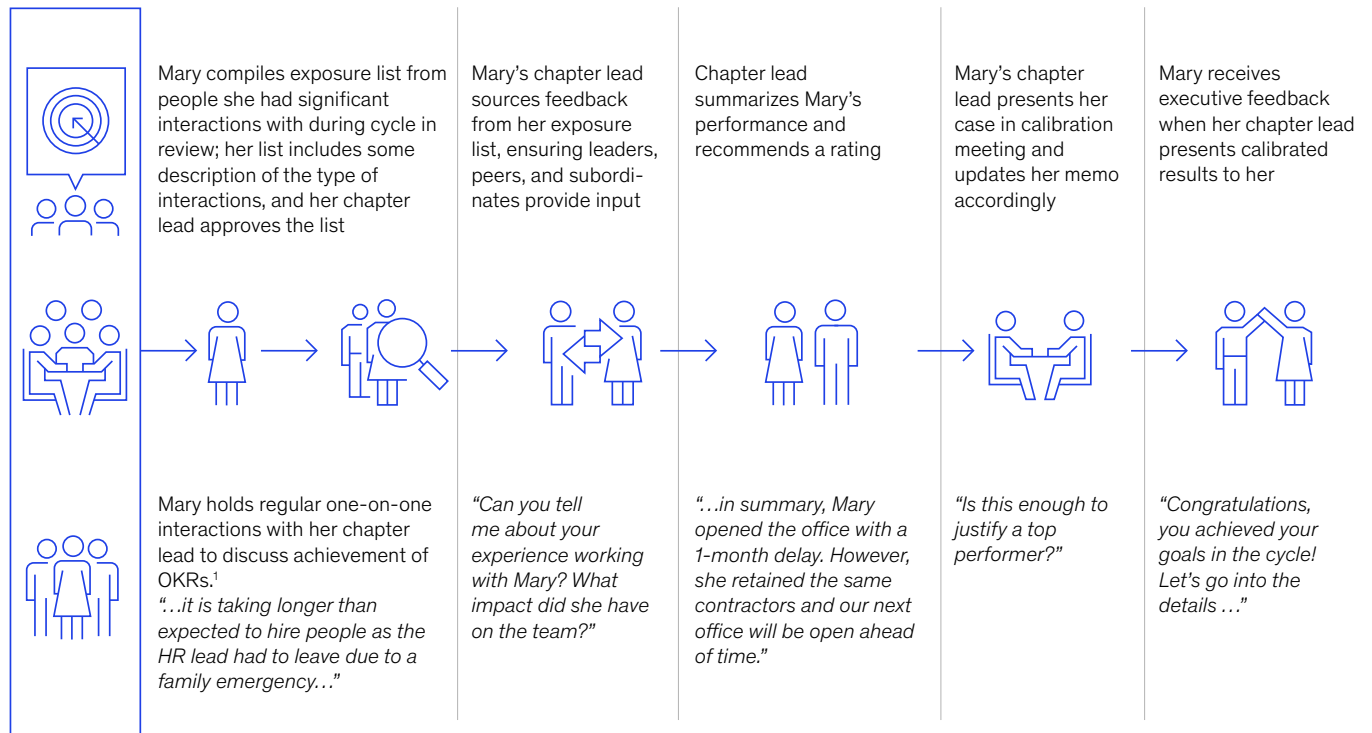
Employees are more likely to view their performance-management approach as fair if outcomes are differentiated, particularly at the two extremes of performance. In some ways, this can be harder in agile organizations, at which collaborative and highly interdependent teams mean that it is difficult to trace results to individual efforts. Two practices can help maintain differentiation and the accompanying sense of fairness, without detracting from the team spirit.

Differentiate individual contribution to team performance based on desired values, mind-sets, and behaviors

Successful agile organizations embody agile methodologies and ways of working that are tangible and visible in day-to-day work. Less tangible, but a critical stable practice of agile organizations, is culture—the strong, shared

¹ Chapters are groups of employees with similar functional competencies who share knowledge and further develop expertise. The chapter lead typically coordinates performance evaluations of the chapter's members.

The performance-appraisal process may also need adjusting in agile organizations.



¹ Objectives and Key Results.
 Source: McKinsey analysis

values, mind-sets, and behaviors that underpin and enable those methodologies and ways of working. Successful agile organizations evaluate and manage performance of individuals not just against hard targets but also by the extent to which the individual has shown and "lived" the desired values, mind-sets, and behaviors. Potential rewards or consequences should be well aligned with these goals. In the case of a telco, for example, rewards for sales teams are based on achievement against individual and team targets in addition to how well and how often employees offer coaching and mentoring to their team members. These contributions should be well codified and recognized because they both motivate individuals and create "pull" for the next opportunity.

Conversely, organizations should make clear choices with employees who don't actively live and show the desired values, mind-sets, and behaviors, as in the case of a fintech company at which individuals not aligned with its core cultural values and defined associated behaviors are simply let go.

Increase the emphasis on intrinsic motivation and nonmonetary rewards

Work at most successful agile organizations is characterized by a sense of fulfillment and fun: it is common to hear employees describe how their daily activity "does not feel like work." Netflix offers flexible benefits, such as unlimited vacation days. Employees stay because they are passionate about their work and the unique culture. While individuals

expect to be paid fairly for their contributions, offering flexible benefits gives agile organizations an opportunity to place greater emphasis on intrinsic motivation and frequent nonmonetary rewards—including special assignments, opportunities to present externally or attend special events, high recognition in the workplace (awards and celebrations), and time for pro bono work. For example, a North America–based fintech company offers unique leadership-exposure opportunities and mentorship programs to reward performance and increase retention.

Organizations embarking on agile transformations cannot afford to ignore performance management. Even teams undergoing pilots need to be ring-fenced from traditional approaches to ensure that agile practices and mind-sets have the freedom to take hold and are appropriately recognized and rewarded. Done well, performance management that is customized to the agile goals and context of an organization will enable full capture and sustainability of the benefits promised by agility.

Lucia Darino is a senior expert in McKinsey’s New York office, **Marcus Sieberer** is a senior partner in the Zurich office, **Arthur Vos** is an associate partner in the Amsterdam office, and **Owain Williams** is an associate partner in the London office.

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