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ORGANIZATION PRACTICE

Encouraging your people to take the long view

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Employees and managers should be measured as much on their contribution to an organization's long-term health as to its performance.

Measuring the performance of people, especially managers and senior executives, presents a perennial conundrum. Without quantifiable goals, it's difficult to measure progress objectively. At the same time, companies that rely too much on financial or other "hard" performance targets risk putting short-term success ahead of long-term health—for example, by tolerating flawed "stars" who drive top performance but intimidate others, ignore staff development, or fail to collaborate with colleagues. The fact is that when people don't have real targets and incentives to focus on the long term, they don't; over time, performance declines because not enough people have the attention, or the capabilities, to sustain and renew it.

Yet measuring, let alone strengthening, the capabilities that help companies thrive over the long haul is difficult. These "soft" measures of organizational health—for example, leadership, innovation, quality of execution, employee motivation, or a company's degree of external orientation[1]—are tricky to convert into annual performance metrics. Moreover, an organization's health may not change much in a single year, and an employee's contribution often comes down to judgments and trade-offs. What risks to take and avoid? Which people to develop, and how? Getting a handle on the employee's personal contribution typically requires in-depth conversations and a more thorough 360-degree style of evaluation than most employees (including senior managers) generally receive. Because of all this, few companies manage people in ways that effectively assess their contributions to corporate health or reward them for improving it.

When companies do try, they often end up using metrics that are discretionary, weighted less heavily than traditional measures of performance, or applied inconsistently. One mistake is to become confused about issues that appear related to organizational health but in practice lie at the heart of an individual's operational, day-to-day job (and are therefore more appropriately assessed in the context of immediate performance). It's fine, for example, to judge a senior product manager's contribution to a company's external orientation by tracking the number and quality of the new external contacts he or she develops over a year. But it makes little sense to apply the same health test to a media relations specialist for whom meeting new people is an essential part of the role. Similarly, it wouldn't be helpful to measure an HR manager's contribution to leadership, capabilities, and innovation (other key features of organizational health) by tracking the time he or she devotes to building the skills of employees and training them—very much features of that person's day-to-day performance.

Managers and others quickly recognize flaws such as these and respond accordingly. At a global consumer goods company, for example, the head of HR admitted that managers view the organization's health-related targets as a lever to "top up" their incentive packages. That was hardly the effect the company intended, and a perception that's proving difficult to change.

Against this backdrop, we believe it's useful for CEOs and their senior teams to step back and collectively examine how—and in some cases whether—their people-management systems give sufficient priority to the long-term health of their organizations. This article, drawing on work we've done recently with several companies in sectors where execution is central to long-term success, suggests three tried-and-true ways for leaders to build health into performance management. While the specific measures of health that organizations employ will ultimately be unique to them, the principles outlined here should be applicable to any company.

1. Root out unhealthy habits.

Senior executives know in their bones how to handle managers who don't do well on traditional performance measures: provide clear feedback, a development plan to address the problem and build the necessary capabilities, and an evaluation to judge progress. The processes for handling such issues are second nature to most companies.

In principle, the same should go for incorporating measures of organizational health. In reality, however, the organizational processes and mechanisms companies employ may well send mixed messages about the importance of health and even undercut it. Often, it's necessary to start by unlearning bad habits. High-hazard companies, for example, have had to do just that in the wake of much-publicized accidents and subsequent pressure from regulators and consumers for improved safety.

One such company started by conducting an audit of critical roles across the organization and compiling a list of all the key safety-related competencies required for each of them. The goal was not only to ensure that workers had the necessary technical know-how and leadership skills but also to spot HR processes, systems, or managerial-training programs the company needed to change so that problems identified at the line level could be traced to their roots.

It was one thing for the company to add more realistic emergency scenarios that line managers and their teams could act out together, another to insist that the new approach be taken seriously. Managers who struggled with the new simulations were therefore removed from their roles until they improved, even if their previous track record of operational safety had been impeccable.

Mechanisms alone, in other words, won't cut it. Getting organizations to assess and compensate managers on their contributions to health, and to view this issue as a deal breaker (or maker) in promotion decisions, often requires a significant shift in company culture. Strong support from the CEO and executive team is a must.

The high-hazard company began to succeed with its new corporate-health agenda only when senior executives who personified the new ethic—longer-term performance as the priority—were promoted. Only then did employees start to believe the change was real. Changing promotion criteria is, of course, difficult at the best of times but particularly so if no one is ready to replace existing role holders. This reinforces the need for a strong talent pool and the importance of building health into a company's broader talent-development strategy (and metrics on corporate health into the performance appraisals of senior managers responsible for it).

2. Prioritize values.

Identifying the right values requires discussion and debate, informed by extensive engagement with a range of employees, among senior leaders. Organizations conducting such discussions are beginning to create metrics that shed light on how well employees respond to particular health-related values.

Leaders of a global pharmaceutical and consumer goods company, for example, prioritized a number of values, such as treating others with respect, behaving with integrity, and managing for the long term. To give managers a qualitative basis for evaluating the way employees upheld these values, the company began introducing clearly defined standards of leadership in each of them. In addition to gauging business results, the standards include the qualitative measurement of softer skills, like developing organizations and people, mastering complexity, and focusing on customers and market conditions. The moves are helping to create a common language for discussing how the company gets results, not just *what* they should be.

Airlines too depend on their values. All airlines must prioritize safety to succeed, but to embed this important ingredient of long-term health, many voluntarily go beyond what regulators require. Some create detailed performance-management metrics to dig into the nature of key interactions that a company values highly—for example, to see how well flight crews work together to solve problems or how pilots and flight attendants interact. (Rooting out excessive hierarchy in such relationships is important because flight attendants are often the first to spot in-flight troubles and must therefore feel empowered to respond decisively.)

The pilots of one Middle East–based airline frequently write incident reports that candidly raise concerns, questions, and observations about potential hazards. The reports are anonymous and circulate internally, so that pilots can learn from one another and improve—say, in handling a particularly tricky approach at an airport or dealing with a safety procedure. The resulting conversations reinforce the safety culture of this airline and the high value it places on collaboration. Moreover, by making sure that the reporting structures aren't punitive, the airline's executives get better information and can focus their attention where it's most needed.

Emphasizing health-related values can be particularly important in turbulent times. During a significant change-management effort, executives at a North American manufacturer codified a list of leadership values for which it would hold managers accountable. These included softer values, such as putting people first and teamwork, along with more traditional performance-related goals, such as continuous improvement and drive for results. The effort sent employees an important signal that management was serious about changing how the company worked. The resulting performance conversations and role modeling by senior executives are reinforcing the company's commitment to health, much as the employee discussions at the Middle East airline reinforced the values of safety and cooperation.

3. Keep it simple—but meaningful.

A final principle companies should embrace when trying to improve organizational health is simplicity. In short, don't let the metrics get out of hand. Companies sometimes try to impose a comprehensive set of health measures on each employee, though a handful of well-chosen ones would suffice. A certain organization, for example, discovered that over time it had captured so many hundreds of competencies in its performance-management processes that it couldn't manage any of them actively. Similarly, a professional-services firm we studied introduced a suite of health-related metrics so complicated and bureaucratic that few employees took them seriously.

Poor outcomes are more likely when the affected business units don't get involved with corporate-health measures. Best-practice manuals delivered from on high tend to be ignored or scorned. By contrast, the best companies encourage business units to play a meaningful role in determining how to translate health-related goals into a handful of metrics on which to act.[2] Since some of the metrics will be new—and, often, qualitative—senior executives should work with leaders of business units to make sure that the metrics are "owned" by employees and remain up to date and effective, and that business units have the investigative skills to gather the necessary data from multiple sources.

Another thing business units can't always do alone is look at the big picture and act on it. Here again, simplicity is essential. For example, one global energy company relies on a central audit team to aggregate a number of metrics used by the company's core business units into a single, simplified report for corporate-level leaders evaluating personnel, incentives, and career progression plans for business leaders.

What's crucial is to develop mechanisms that reward people while corporate health improves. For example, one oil and gas company links incentives associated with big capital projects to their operational results two to three years after launch. That's long after the managers involved in the original decisions have moved on to other tasks.

Once companies develop the right handful of health metrics, define the behavior that supports them, and implement assessments of the willingness of employees to practice that behavior, the final step is ensuring that their compensation reflects contributions to health. This should be true for senior executives as well—indeed, we believe that organizational health warrants more consideration in executive-level compensation decisions than it often receives.[3]

Of course, the balance between health and performance will vary by company and context. But in our view, companies should start with the expectation that health-related considerations are just as important as performance-related ones. Some companies may go so far as to base monetary compensation equally on contributions to performance and health (as a European bank recently did). Others focus more on nonfinancial rewards—in particular, for employees in technical disciplines. Given the proven power of nonmonetary incentives to drive positive behavior, such moves are wise and worth investigating further.

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Over time, traditional hard performance metrics can encourage short-term success at the expense of an organization's long-term health. By starting to think about individual performance in the light of the three core principles discussed here, companies can start spotting ways to make sure their people-management systems are built for the long haul.

[1] For more, see Scott Keller and Colin Price, "Organizational health: The ultimate competitive advantage," mckinseyquarterly.com, June 2011.

[2] See Aaron De Smet, Mark Loch, and Bill Schaninger, "The link between profits and organizational performance," mckinseyquarterly.com, November 2007.

[3] For more about CEO compensation, see David F. Larcker and Brian Tayan, "Does your CEO compensation plan offer the right incentives?," mckinseyquarterly.com, April 2012.

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