

**Evaluating HR Strategies & Programs**  
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Once a compensation, benefits or performance appraisal program is installed few organizations conduct continuous, or even periodic, evaluations of the program's effectiveness and continuing appropriateness. But programs running on auto pilot can do a lot of damage if someone is not watching the instruments to determine if they are keeping them on the right course. At stake is cost effectiveness, employee satisfaction and employee motivation. The effectiveness of any strategy or program will be impacted by environmental factors and given the rate of change experienced by many organizations today it is unlikely that programs in place for long periods will be as appropriate and effective as they were when first implemented... and strategies need to be refined as well, although they may have longer lifespans before requiring change.

This paper presents models for evaluating programs on a continuous basis. Experience is shown that unless an evaluation model is fashioned when a program is designed and implemented it is unlikely that enough attention will be paid to its effectiveness on an ongoing basis. Without pre-determined performance criteria, standards and measures evaluating a program is difficult, at least until things have gone so wrong that serious problems become obvious. All too often outside "fire fighters" are brought in to deal with a raging inferno... a much more costly strategy than having a sound fire prevention program. But after the fact remedies cannot undo the damage and employees tend to be unforgiving when programs close to their hearts (or wallets) are declared to be defective, particularly when they had been promised that the programs were going to be so much better than what they replaced.

**Designing The Program Instrument Panel**

The balanced scorecard approach that has received so much press the last few years uses an "instrument panel" approach to defining and measuring performance. In order for a scorecard to work the performance criteria, standards and measures must be designed in advance, hard wired into the psyche of managing and continuously monitored so that effectiveness can be evaluated. The same principle holds true for a program, such as a new merit pay program. The gauges in the instrument panel each represent an objective of the program, translated into a performance measure. For example, an objective of moving to pay for performance is often to divert a larger share of the pay increase budget to better performers and a smaller share to poorer performers. A measure of allocation (average increase related to performance rating) becomes a gauge in the evaluation instrument panel and results can be monitored.

Another category of measure used to evaluate program effectiveness is perceptions. What people believe to be the intent and/or reality is what is real to them. In the case of the merit pay program another measure may be the extent to which employees believe higher levels of performance result in larger pay adjustments. Perception can be compared to reality (measured by the first gauge created), giving an indication of gaps that exist. If both gauges yield desirable values it can be assumed that pay is being tied to performance and that the employees realize this is the case. One without the other makes the program less impactful and less effective.

Exhibit 1 illustrates a generic model that can be used as the basis for developing an instrument panel for a specific organization.

**Exhibit 1**

**Program Evaluation Model**

<b>INDIVIDUAL PROGRAM</b>
<b>Objectives</b>
<b>Method/Process</b>
<b>Results (measures)</b> <i>Actual</i> <i>Perceived</i>

Once program objectives have been used to guide program design (both methodology and process) the performance criteria, standards and measures that will be used to evaluate results can be formulated. Technical (actual results) audits are far more common than perceptions audits and therefore actual results often dominate evaluation activity. The focus on actual results is of course necessary but all too often misperception can be the source of employee dissatisfaction, management misunderstanding and general frustration.

Exhibit 2 presents the results of a perceptions audit relating to the distribution of performance ratings during the first cycle of a new program. What it demonstrates is that there are significant gaps between actual results and what executive management thinks is actually happening and between what employees think is happening and the actual results. Both of the results can be damaging. About the only good news is that the managers who did the ratings are closer to guessing the truth.

## Exhibit 2

### Distribution of performance ratings: actual and perceived

Performance Rating	Actual Results	Executive Perceptions	Mgr./Super. Perceptions	Employee Perceptions
Outstanding	22%	15%	20%	5%
Sig. Exceeds Standards	50%	25%	30%	10%
Fully Meets Standards	25%	45%	35%	60%
Does Not Fully Meet	2%	10%	10%	15%
Unacceptable	1%	5%	5%	10%

The executive misperceptions can be very damaging to the careers of HR, the rating managers or both once the reality is known. The performance appraisal program could be found to be at fault, but it is more likely that poor training or the absence of any monitoring of performance ratings is the source of the malfunction. It is critical for HR to detect this misalignment and to act on it... either to align executive perceptions with reality and/or to communicate to managers that ratings are out of line with expectations (if they are).

The employee misperceptions can also be the source of discontent. If an employee is rated "significantly exceeds" the belief will be that he/she is in the top 15% of their peer group and deserving of significant rewards. The reality that performance falls somewhere between the 77<sup>th</sup> and the 27<sup>th</sup> percentile will no doubt result in a pay action that will be disappointing and viewed as unfair.

Whether the actual results are deemed to be good or bad will depend on the culture of the organization and management's philosophy. One further issue that should be addressed is the consistency or lack thereof across the organization, since problems may be occurring in specific functions, making them a bit easier to deal with.

Exhibit 3 is the second part of this perception audit, which is to measure the degree to which pay actions are correlated to performance ratings and compare actual results to perceptions. Once again, there are significant differences between the views of both the executives and the employees and what is actually happening.

### Exhibit 3

#### Pay actions vs. performance ratings: actual and perceived

Performance Rating	Actual Results	Executive Perceptions	Mgr./Super. Perceptions	Employee Perceptions
Outstanding	7%	15%	9%	6%
Sig. Exceeds Standards	6%	9%	7%	5%
Fully Meets Standards	6%	5%	6%	4%
Does Not Fully Meet	5%	1%	3%	3%
Unacceptable	2%	0%	0%	0%

The issues with these findings are many, both technical and perceptual. First, the actual results show little correlation between performance rating and pay adjustment. Given these average increases and the rating distribution in Exhibit 2 the organization will have had to spend well over 6% of payroll and yet will have accomplished little differentiation between the highest and lowest level of performance. Most organizations would consider the program a failure.

Perception problems are also significant. Executive management believes pay is being adjusted based on performance and will probably not view the results as anything but a disaster. However, if there has been no history of paying for performance it would probably be unrealistic to expect an overnight conversion to totally different behavior. If HR had been prudent enough to analyze the proposed ratings and adjustments prior to their being effective (and being communicated to employees) there is still an opportunity to adjust the pattern, although executive management support for adjusting recommendations will be required. As mentioned earlier, conclusions based on overall averages may be premature... the problem may be with inconsistency across the organization. In any event it would not be career enhancing for managers or HR if these increases became effective and executive management only found out the truth later.

The employee perceptions are also a large problem. Although they rightfully believe there is little difference between performing well and performing poorly they also believe the organization is spending a lot less than it really is. It is one thing to be cheap but yet another to be spending lavishly and to be thought to be cheap. People act on their perceptions and if you combine the employee beliefs about rating distributions and pay increase distributions they would assume the organization is spending less than 4% on increases. This clearly is not a winning combination for the organization... spending a lot and getting little credit.

Once an evaluation model has been built and objectives established for both actual and perceived results the organization is able to continuously monitor the gauges and to act to prevent year-end results such as those just offered as an example.

### Evaluating Programs Using The Model

The evaluation of a base pay program will be used as an example of how the evaluation model can be applied in an audit. Other types of programs (benefits, incentives, etc.) will typically have different objectives and methods/processes and will therefore involve different effectiveness criteria, standards and measures. But the concept is the same: 1) align program design with objectives, 2) develop both actual and perceptual measures to use in evaluating program performance and 3) use the results to make changes to program design and/or to the perceptions of the parties at interest.

### Program Objectives

The most common objectives for a base pay program are: 1) attract and retain required skills, 2) motivate high levels of performance, 3) administer programs efficiently and within established budgets and (sometimes) 4) provide employees with a standard of living appropriate to their role in the organization. The attract/retain objective may be made more specific by stating that pay opportunity will be consistent with internal equity and external competitiveness and that individual pay rates will be based on performance and job mastery. However objectives are stated it must be possible to test program performance against them to make evaluation meaningful.

### Program Methodology and Process

The elements of a base pay program are outlined below, with key questions provided that should be answered during an evaluation.

#### Pay Policy:

- How are the labor market(s) within which the organization competes defined? Do they differ across occupations?
- What should the competitive posture be relative to those markets? What is the actual competitive position?
- What elements does the direct compensation package contain (base; variable) and what is the mix? Is it appropriate?
- What does the organization base pay opportunity on: job held, results produced or qualifications – or a combination? Is the current approach appropriate?

### Role Definition & Documentation

- Are jobs well designed and documented?
- Is documentation current and complete?
- Do employees understand job requirements and expectations?

### Pay Structure

- Is the process for grading jobs effective and efficient?
- Is the process viewed as fair and is it efficient of resources?
- Is the number of grades appropriate?
- Are the grade assignments viewed as fair and appropriate?
- Is the market pricing process appropriate?
- Are pay ranges competitive?
- Are pay ranges an appropriate width?
- Is there a process for identifying changes to job responsibilities and requirements and adjusting grades/ranges as appropriate?
- Is the pay structure adjusted each year consistent with market conditions?

### Pay Rate Determination

- Is the process that sets pay rates for new entrants appropriate?
- Are pay adjustments based on the right criteria? (e.g., performance, mastering skills, producing results)
- Are pay adjustments fair and appropriate?
- Are pay adjustments non-discriminatory? If there is statistically significant adverse impact on a protected class has the cause been identified and validated as appropriate?
- Is there a credible appeal process available to employees?

### Performance Appraisal

- Is performance appraisal based on job-related results and behaviors?
- Are performance criteria, standards and measures defined in advanced and communicated?
- Are raters appropriately trained?
- Are ratings non-discriminatory? If there is statistically significant adverse impact on a protected class has the cause been identified and validated as appropriate?
- Is there a credible appeal process available to employees?

### Program Administration

- Do the program costs stay within the overall budget?
- Is there consistency across the organization?
- Is communication adequate to produce employee understanding?
- Is there a need to reconsider methodology or process?

## Determining The Business Impact Of Program Modifications

An issue related to evaluation of program effectiveness is determining whether changes to programs will be good business decisions. All too often HR makes the case for modifying a program to fix a problem without including the hard figures that determine if it is a good economic decision. The example of reducing turnover in a critical occupation will be used here to demonstrate how the business case can be made, thereby putting the proposal in the primary language of the decision makers.

**Fact:** turnover among Software Design Engineers has been 25% and this level of churn has had a negative impact on project performance and customer satisfaction. **Proposed by HR:** increase the pay level of incumbents from market average (\$80,000) to 10% above market average (\$88,000). **Cost:** There are 100 incumbents: the annual cost of increased payroll is \$800,000. **Projected benefit:** turnover will drop from 25% to 15%, reducing the number of unwanted leavings by 10 designers. For the purposes of this illustration let us assume HR determined that other organizations had experienced similar results after taking the same action and that the projected drop in unwanted turnover is believable. *How can the case for this action be made in business terms?*

Cascio<sup>1</sup> provides costing models for use on HR issues such as turnover, absenteeism, work-life issues and the like and his approach can be used to put benefits (cost avoidance in this case) into financial terms. HR must be able to provide average cost figures for events such as this, which would include:

- HR resources required to recruit a new employee
- Productivity lost in the unit
- HR resources required to onboard a new employee
- HR resources required to train a new employee

These are not all the related costs of course. Delays in product development, impact on customer relations and other operational impact will be difficult to estimate accurately and this should be up to the management of the concerned unit. But HR must be prepared to provide management with hard figures on what the cost avoidance will be that is associated with losing and then replacing ten designers. HR may also provide information on other outcomes that cannot be estimated in dollar terms, such as the need to pay new recruits more than even the \$88,000 target, due to labor market shortages, and the impact a premium would have on the equity perceptions of the Designers already on board. Certainly these possible consequences need to be presented along with the expected costs – not to do so would underestimate the benefits associated with raising the pay levels. But it is likely the decision will turn primarily on the hard costs and if they are not forthcoming then the proposal will have a lesser chance of acceptance.

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<sup>1</sup> Costing Human Resources, 4<sup>th</sup> Ed., W. F. Cascio, Southwestern Publishing, 2000.

Once the change has been implemented it is HR's responsibility to track the results. Although extenuating circumstances (e.g., competitors respond by raising pay levels 15%, the labor market tightens further, etc.) may intervene it is important for HR to test the actual benefits against those estimated and to make management aware of those results. Successful interventions such as the pay adjustment will build the credibility of HR and place HR programs on the same plane as other investment decisions.

### **Performing Evaluations**

The critical questions relating to program evaluations are: 1) how will they be done, and 2) who will do them, and 3) what will the role of each party at interest be? The first question has been addressed. The issues concerning who should participate in evaluations and what the roles of the respective parties should be are too important not to discuss, however, so options will be presented here.

It is most common for Human Resources to be responsible for ensuring programs are effective and appropriate. However, since HR typically leads the design or programs and is held accountable for their performance it raises credibility questions if HR conducts evaluations. This is not to suggest that HR would knowingly misrepresent program performance, but rather that an all HR evaluation team would bring an all HR perspective to the process.

Having the internal audit function of the organization perform program evaluations certainly is a feasible option, especially if their scope includes operational audits, rather than strictly financial audits. Their role could be to establish the "what is actually happening" portion of the picture, determining if managers are acting in a manner consistent with established policies and procedures. But it is unlikely that the auditors will have much to contribute to the "what should be" question or "what do employees think is happening" issue. If employee attitudes are to be surveyed using a structured questionnaire auditors could perform this analysis, but increasingly perceptions are gained through focus groups and other interactive processes and this may be outside the competence of an auditor.



One approach is to separate the evaluation process into an *audit*, which analyzes what is happening, a *perceptions evaluation*, which determines what people think is going on and a *policy review*, which involves management and HR in determining if the program objectives or guiding principles need to change. The internal audit function could lead the first portion, HR (and perhaps employees themselves) the second portion and HR and executive management direct the third. HR is all too often the “rules police” anyway and the auditing portion is where objectivity is most valued, so this approach removes some of the suspicion about bias from the evaluation.

Having the audit portion performed by a neutral party has been made even easier because of the technology that is now available. The HRIS of today provides a number of facts that can be used as diagnostics and that allow for objective evaluation.

For example, compa-ratios (the ratio of current pay to some intended target, such as the midpoint) can be calculated for individuals, departments and classes of employee very easily. Calculating the compa-ratios by gender, race, age and even grade level can provide useful information for beginning a diagnosis of the workings of a pay program. If compa-ratios for minorities are found to be lower than similarly situation whites (same grade, same performance, same competence and same longevity) this can point the HR sleuths to potential inequities. A finding that there is statistically significant adverse impact on a protected class does not establish that something is wrong or that discrimination exists, but it can highlight the need to establish the causes and to determine what if anything needs to be done about it. The audit produces the indicators, but the further investigation should become the responsibility of HR, due to the knowledge and skill of the function’s staff.

A finding that the compa-ratios increase as the grade level becomes higher does not in itself establish anything. It may be that higher market rates have forced pay levels up in the higher grades and it may also be that there is more longevity among more senior level professionals and managers. On the other hand, if performance ratings are shown to be higher as the grade level increases this finding should be turned over to HR, to determine if the performance management system is understood and if it is being properly administered.

Inconsistency across functions is perhaps the most fertile ground for further expert investigation by HR. It may be that specific functions in short supply in the marketplace have been targeted to be paid higher in the ranges, to ensure those in critical occupations can be attracted and retained. Other occupations may have control points that are below range midpoints, either because they are not critical to the performance of the organization’s primary business.

For example, if a Hospital is paying RNs higher in the established pay ranges than they are Accountants it may reflect a policy to divert funds to critical occupations, in order to deal with skill shortages. On the other hand, if the pattern does not coincide with a conscious policy HR may wish to examine the causes further. Again, the expertise of HR is needed in this phase of program evaluation.

Chris Argyris, the renowned behavioral scientist, provided guidelines for evaluators that are both practical and sensible. He contends evaluators should avoid taking the decisions away from the proper decision makers by providing complete, verifiable, unbiased information in a manner that leaves the decision to the designated party. The unbiased part is difficult, since posing alternative actions seems the natural outgrowth of evaluation. But if the evaluator narrows the range of options during the process of providing recommendations this may intrude on the decision makers realm. A fine line indeed, but one that can be defined by having the decision makers clearly prescribe the type of information they require. If the marching orders are to evaluate all options and to present the two or three deemed most appropriate this should be the product of the evaluation. On the other hand, it is always a good idea to document the rejected options, if only in an appendix, so the final decision maker can determine what was looked at and why certain options were rejected.

Another bias that can be dangerous is a bias in favor of change. Activity is often taken to demonstrate the evaluator is "proactive," "a change manager" or some other noble characteristic. But the most honest evaluation may result in a finding that a program is just fine. This is a hard conclusion to present, since resources have been expended and it is often felt something should come of it. Too often evaluators justify the effort by nit-picking on minor issues or leaping forward to changes that could be made that would make the program even better. If this is the charge it is the proper thing to do. But it should always be remembered that most employee populations have had quite enough change over the last decade and tinkering with their pay program may not be the best way to increase their satisfaction levels. Overlooking defects in program operation is not suggested, but rather that things that are just fine should be found to be just fine.

## Applying The Evaluation Results

The bottom line of any evaluation is what will be done as a result of the findings. More change does not automatically equate to an effective management response. And radical change is often disruptive, to be avoided unless it is deemed to be absolutely necessary and pressing in the short term.

Most programs atrophy over time and it may be better to manage a change effort to correct major alterations over time rather than to attempt immediate fixes. The most important tool for early diagnosis and gradual correction is to evaluate early and on a regular basis, so actual results and/or perceptions do not drift significantly off course. Fixing many small issues can often be easier than waiting until a major crisis is at hand. Programs that have become totally ineffective will become apparent to all parties and there may be little choice but to put them out of their misery and to undergo a new program design and implementation. In addition to the resource consumption that takes place when a totally new program must be created there should be concern about the impact the program failure will have on the reputation and future standing of HR and of management.

Modifications to programs, if done when needed, can be accepted as normal evolution to keep the program aligned with the realities of the organizational context. They also can usually be accomplished without bringing in outside resources and without stirring up huge clouds of dust. Few employees can remain calm when programs close to their hearts and wallets are being substantially changed. And these upheavals will have a negative impact on the confidence level of employees that management knows what it is doing.