

Performance adjustment: Improving the performance management model

*Robust performance
management can be a
game-changer for financial
institutions struggling to
attract and retain talent.*



The heart of the matter

Outside of financial services, many companies believe the traditional performance management model requires a complete overhaul. For financial institutions, however, we contend that a complete overhaul is not a practical solution. Why? A typical financial institution must satisfy the often-competing demands of multiple stakeholders such as customers, employees, regulators, boards, and shareholders. We recommend adjusting the traditional performance management model using a targeted approach.

Performance management is top of mind at many financial institutions today, likely because various stakeholders have competing views as to what it should accomplish. Regulators, for example, look to performance management to manage risk and employee conduct (that is, by demonstrating how irresponsible risk taking invites consequence—both in compensation and otherwise). Executives use it to motivate performance and encourage desired behaviors. Shareholders, particularly activist shareholders, look to performance management to oust poor performers in the

hopes of improving shareholder returns. And employees expect it to help them grow professionally and reward them with raises and bonuses for their hard work.

Financial institutions also face an increasing talent shortage. In fact, according to PwC's Annual Global CEO Survey for 2015, 70% of financial services CEOs see the limited availability of key skills as a threat to growth prospects, up from 59% last year.¹ This is especially daunting for those looking to shore up key skills, such as risk management, compliance, and innovation.

We believe that robust performance management can offer benefits that are critically appealing to millennial workers and other stakeholders. These include:

- Traditional performance management models in financial institutions share the following characteristics:
- Annual performance period
 - Performance goals determined in Q1; formal reviews held (semi-) annually
 - Performance ratings (at year-end) representing relative performance (sometimes allocated under forced distribution)
 - Inputs to ratings considered once (or sometimes twice) a year against a balanced scorecard of measures
 - Performance ratings (typically between 1 to 5) affecting the employee's incentive outcome.

- Career paths that offer a wide range of opportunities.
- Differentiated reward and recognition outcomes that align to the financial institution's risk culture.
- A culture of high performance and real-time feedback.

For the purposes of this whitepaper, the "traditional model" refers to performance management models that adopt these common features.

¹ "18th Annual Global CEO Survey: Key talent findings in the financial services sector," PwC, February 2015.

60% of female millennials in financial services see opportunities for career progression as the most important attribute in an employer.²

Many companies outside the financial services industry are contemplating a complete overhaul of their traditional performance management model, including abandoning ratings. While it may be tempting for financial institutions to follow this lead, we caution that demands from regulators and shareholders for greater transparency in performance and reward practices are higher for financial services than those placed on organizations in other industries.

In our view, financial institutions should work to enhance their employee value proposition by improving the execution of the traditional model to better engage the emerging cohort of millennials, derive greater business value, and enhance their appeal to the up-and-coming talent pool. In brief, rather than throwing out the traditional model, they should improve it instead.

When done well, performance management engages and motivates employees, and provides defensible rewards that encourage risk-responsible behaviors and a focus on the “right” things, such as making the customer the top priority, building a healthy risk culture, improving and innovating the business, and engaging in corporate responsibility. Performance management also enables targeted (individual) performance focus and offers rationale for performance management outcomes—both good and bad—including rewards, promotion opportunities, and development priorities.

We predict that those financial institutions that make a “performance adjustment” will be better positioned to attract, engage, and retain top talent over the long term while also helping to satisfy numerous stakeholder demands and expectations.

² “Female Millennials in Financial Services: Strategies for a new era of talent,” PwC, May 2015.

An in-depth discussion

The case for change

Stepping up the way performance is managed can relieve some of the pressures and talent challenges that financial institutions face today.

Performance and reward practices in financial services are under regulatory scrutiny.

Having examined how risky behavior played a part in the financial crisis, regulators now encourage financial institutions to use appropriate performance and reward approaches to drive desired behaviors.

By now, many financial institutions have implemented new policies and removed performance and reward frameworks that, at worst, encourage risky behavior and, at best, fail to penalize it. As old behaviors are stamped out, financial institutions should be clear on what behaviors they want to encourage in a post-financial-crisis world, such as risk awareness, quality assurance, and customer-centricity. Performance management provides the key to presenting these behaviors to employees in a way that goes far beyond lip service—it “puts skin in the game” and holds employees accountable. For example, we have seen financial institutions consider compliance, risk, and audit review findings as an input into performance, rewards, and promotion decisions for management in specific business units.

Financial institutions continue to shift strategies and operating models.

Within banking alone, companies face a wide array of change: new branch models, disruptive digitization (such as payment technologies), heightened cybersecurity concerns, restructured cost bases, and the growing prevalence of regional and non-traditional financial services players.³

It is our view that these shifting strategies can be translated into meaningful individual performance objectives that focus employees on the “right” things only if a robust performance management infrastructure is implemented.

Financial institutions cannot reward top performers with compensation to the extent that they used to.

Revenues—and thus bonuses—are under fiscal and regulatory scrutiny, while the reward premiums historically paid in financial institutions are, in many cases, drying up. Caps on rewards, as well as other risk-controlling mechanisms (such as deferrals and clawbacks), have devalued the employment deal relative to the pre-financial-crisis era.⁴ This undercuts the means by which financial institutions have traditionally attracted, engaged, and retained talent.

³ “Retail Banking 2020: Evolution or Revolution?” PwC, January 2014.

⁴ *Deferral*: A component of an individual's award that is deferred for a period and will vest only when certain conditions are met (for example, tenure, performance, compliance).

Clawback: A provision that allows a company to recoup all or a portion of an award when certain conditions are met.

For more information, see our publication, “Executive Compensation: Clawbacks 2014 Proxy Disclosure Study,” www.pwc.com.

Three-quarters of respondents to PwC's 2014 Global Banking Risk Culture Survey said they were more motivated by financial rewards than by less tangible rewards.⁵ However, we have observed financial institutions changing reward models, making rewards harder for employees to earn in post-financial-crisis financial services. With the "pie" shrinking, employees need to understand how performance translates into rewards so that everyone has a fair chance for a piece of the pie.

Demands on the financial services employee value proposition are mounting.

With a growing percentage of the workforce coming from the millennial generation, employers face new employee demands, such as increased expectations for development and coaching, global mobility, flexible work-life balance, and opportunities to help with innovation.

In parallel, we see a migration of top talent to companies in industries that tend to be viewed as alluring and employee-centric. These organizations are famous for innovation and offer comparable (if not better) pay and few regulatory constraints related to rewards, in addition to greater work-life flexibility and other benefits.

The evidence is mounting: Financial institutions need to find new ways to attract, engage, and retain talent.

Our industry observations

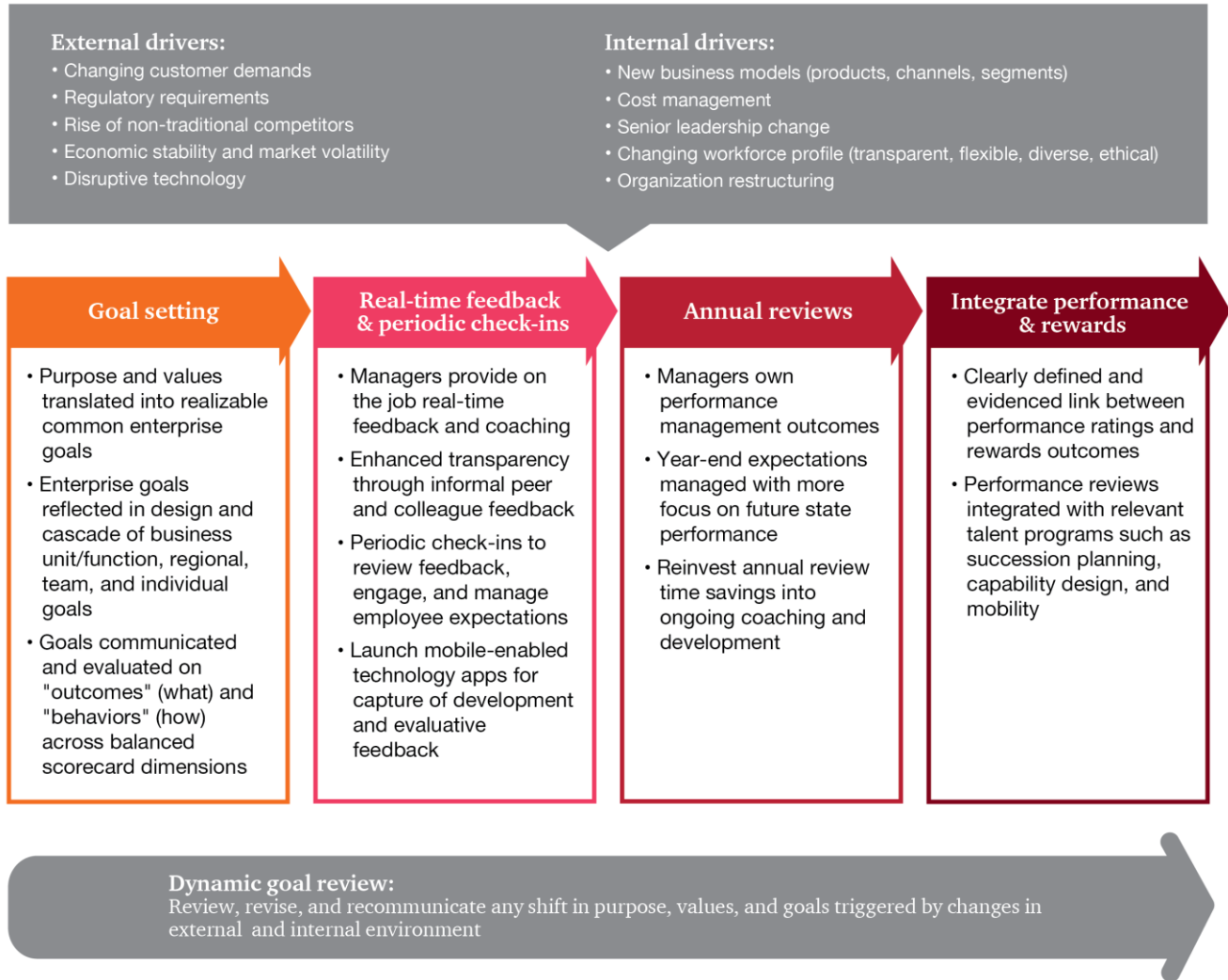
We've heard considerable rhetoric across various industries about the suitability of "traditional" performance management models in modern business. The most extreme critics suggest that this model is fundamentally broken. Others suggest that performance ratings should be discarded.

While these views are less common in the financial services industry, it is often acknowledged that most financial institutions fail to realize the full value of performance management.

The traditional performance management model is defensible in many ways. It encourages employees to establish goals and differentiates employees based on their performance. Despite this, many financial institutions believe that opportunities exist to improve the way performance management is executed to better engage employees, derive greater business value, and better adapt to evolving regulatory requirements (see Figure 1).

⁵ "Cure for the common culture: How to build a healthy risk culture," PwC, October 2014.

Figure 1: Key areas for improvement to the traditional performance management model



Enhancing performance management: Why wholesale change might not be the answer

Despite considerable rhetoric regarding the flaws in performance management, we don't believe that the traditional performance management model is fundamentally "broken" as some suggest. Absolutely, there is room for improvement. But we caution financial institutions against embarking on a wholesale overhaul of their existing model for these reasons:

- **Regulators demand increased transparency.** Regulators expect to see a demonstrable link between performance and reward outcomes (particularly for material risk-takers) to reinforce effective risk management.⁶ While performance ratings aren't perfect, a less formulaic construct (for example, one in which performance ratings are eliminated) removes the traceability between performance and rewards and decreases transparency.
- **HR investments span the entire talent ecosystem.** Financial institutions are seeking to address business issues such as growth, cost, risk, and disruption by enhancing the return on investment of re-engineering the hiring process, enhancing the employer brand, rolling out culture changes, and uplifting critical skill gaps through learning and development. As a result, investments in performance management should be evaluated against a portfolio of other human capital investments, as well as be pragmatic and focused on addressing future business and talent strategies. A disproportionate investment in transforming

performance management—in isolation—may not meet these requirements.

- **Performance management should not be addressed in a vacuum.** To attract and retain talent, financial institutions should continue to redefine their employee value proposition from one weighted heavily toward financial rewards to one that places emphasis on purpose and culture, career advancement, and development. We have observed some financial institutions making investments to align the organization around a compelling sense of purpose and implement diversity and inclusion programs. In addition, they have promoted career advancement and development by establishing accelerated learning programs, transparent career paths, succession planning at lower levels, real-time feedback, and on-the-job coaching. We believe that improvements to the traditional performance management model can complement a new age employee value proposition to deliver on these important attributes as opposed to a wholesale replacement of the traditional model.

⁶ Material risk-takers are "employees for whom incentive compensation arrangements may, if not properly structured, pose a threat to the organization's safety and soundness," according to the Federal Reserve Bank.

Our recommendations

We recommend the following six enhancements to the traditional performance management model.



Coalesce leaders around the importance of performance management

Leadership alignment is crucial to driving meaningful change. But what do we mean by “leadership alignment”?

First, leaders should coalesce around the case for change. Business and HR leaders should co-create the case for improving performance management. HR should play an important role in helping leaders articulate the value of performance management, its linkage to strategy, and its benefits to a diverse set of stakeholders—including current and future employees, regulators, clients, investors, and shareholders. However, HR alone is not enough.

Second, executives should act as champions for the updated performance management culture. Business leaders should understand and articulate the purpose of performance management and how it taps into the execution of business strategy. They should also recognize the tactical implications of the strategy to:

- Set strategically aligned performance goals for staff.
- Identify “right” and “wrong” behaviors.
- Provide meaningful feedback on a real-time basis.



Get goals right

Defining the right goals is critical to extracting maximum value from performance management. We recommend creating a line of sight between enterprise, lines of business, and individual goals—with close attention to potential areas of conflict, such as product versus client and cost versus quality metrics. The key is to strike an appropriate balance between metrics that emphasize the “what” (revenue, profitability, and cost) and the “how” (collaboration, risk, and client experience).

To help financial institutions get the goals right, we recommend the following:

- Establish, at the executive level, a uniform understanding of the operational requirements of the strategy.
- Embed a robust process for cascading goals from the top of the house to all levels in the organization to achieve a common performance focus.
- Perform an executive-level review of goals as part of the annual goal-setting process to confirm that functions are working in coordination with one another and not in contrast. This will help to prevent functional silos.
- Train managers on goal setting to help them determine appropriate performance goals for team members.
- Set motivating performance objectives that adopt SMART (specific, measurable, attainable, realistic, and timely) qualities.

- Adopt a behavioral framework that clearly outlines “good” and “bad” behaviors in an objective fashion—the less subjectivity, the better.
- Encourage dynamic goal setting. Offer the flexibility to adjust goals throughout the year to accommodate any shifts in business priorities at both business unit and organizational levels.



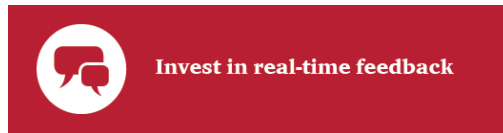
Brand and promote performance management

Financial institutions should develop an internal campaign that appeals to the diverse segments of the workforce (such as front office, back office, millennials, generation X, baby boomers, and contingent workers) and that aligns with both the organization’s strategy and its employer brand.

For financial institutions to properly brand and promote performance management, the following key points should be implemented:

- Obtain executive sponsorship.
- Communicate about performance management within the context of the employee value proposition, highlighting career paths, development, and differentiated rewards for high performers.
- Execute performance management in a way that is aligned to brand values.
- Engage risk and control functions to provide input into performance, promotion, and rewards decisions for key front-office roles.

- Reinforce what employees have to gain, not lose, from performance management. This allows employees to see performance management as an opportunity rather than a punishment.



Today’s workers want to engage in a continuous dialogue regarding their professional growth and development. A PwC study on millennials found that when it comes to communicating career development, 96% of this generation’s workers want to talk face-to-face, just as 95% of their non-millennial counterparts do.⁷

We recommend the following to build a culture of real-time feedback:

- Use technology (such as mobile applications) to help capture real-time feedback. Technology should include a dynamic visualization of feedback received over time plus the ability to provide feedback via multiple devices (such as smartphones, computers, and tablets).
- Have performance reviews go beyond a rating and reward discussion. Place significant focus on development and, ideally, tangible action plans.
- Separate year-end conversations into two parts, with one part focused on performance and compensation, and the other focused on forward-looking development.
- Encourage leaders to “lead by example,” providing and inviting real-time feedback on a regular, informal basis.

Making real-time feedback inclusive of all talent

Because performance management in a high-performance culture takes into account all talent from across the organization—including contingent workers, part-time employees, and offshore staff—consider ways to provide, receive, and capture real-time feedback for these groups of employees, as well as ways to effectively assess—and even rate—their performance. For example, embracing contingent workers in the performance management process creates a shared focus and a culture of inclusion. However, these employees are often separated from the performance management model, denying them the benefits—or consequences—of performance management.

⁷ “PwC’s NextGen: A global generational study,” PwC, April 2013.

An effective performance management program can increase the time spent on strategic priorities by at least 5%.⁸



Improve execution of the performance review cycle

Critics of existing performance review practices point to both the subjectivity of the process as well as the amount of time spent on review activities.

To address the concerns of the critics, we recommend the following:

Performance ratings

- Improve the effectiveness of performance ratings by:
 1. Being clear about the strategic purpose of ratings (for example, to evaluate past performance, identify growth opportunities, or make reward decisions).
 2. Using rating labels that are objective and limited to the scope of job responsibilities or job expectations (such as “meets goals”), rather than labels that could be interpreted as passing judgment on the individual (such as “average performer”).
 3. Rethinking the relevance of a forced distribution of ratings. Consider, for example, giving managers discretion in allocating ratings and calibrating outcomes across teams, or allowing for managerial discretion in the distribution of the incentive pool within teams.

Technology

- Invest in technology (including smart/mobile technology) to simplify the review process and deliver an easy and engaging employee, manager, and HR experience by:

1. Making enhancements that reduce burdens of performance management to affected stakeholders.

2. Establishing technology platforms that illustrate the link between performance and rewards (and especially penalties for poor performers and risk takers). The technology should also bring performance management, talent, reward processes, and data into one integrated platform.

- Do not rely on technology alone to get the job done. For example, only a limited number of tools on the market today are capable of managing the complexity of performance and reward adjustments for material risk-takers. As such, standardizing manual approaches to making these adjustments will be a more practical answer than looking to technology for the “perfect” solution.
- Consider regional variations; what is core and what is common? This is most relevant to international companies and requires knowing what systems are globally applicable, and where regional adjustments are appropriate.

Manager training

- Improve execution of the performance review cycle by providing subconscious bias training to teach employees how to have more fact- and coaching-based, forward-looking conversations.

⁸ “Rethinking your performance management program,” PwC, SAP, 2014.



**Implement a global framework,
that flexes to meet regional/
local ways of working**

To drive consistent behaviors and enable global talent mobility, performance management needs to be consistently executed. However, in-country deployments should take into account any cultural norms and, as such, may result in an array of differences between countries and regions. For example, the appropriateness of providing transparent performance feedback both up and down the chain of command can vary from culture to culture. Deploying a standardized performance management model that respects cultural differences is key.

Financial institutions should adopt a single global model that is flexible enough to adjust for cultural differences, varied degrees of market maturity, capability requirements, and strategic priorities. As part of the model, financial institutions should:

- Perform a cultural analysis to understand any barriers to and enablers for implementing the traditional performance management model (such as cultural norms around feedback). Where these exist, flexibility in the local execution of the framework may be required.
- Customize goal setting and behavioral descriptors to each local strategy through local leadership alignment, defining local behaviors and capabilities, and executing a robust goal-cascading process per country or region.

What this means for your business

Traditional performance management models in the financial services industry are ripe for improvement. Many financial institutions want to realize ambitious organizational and individual benefits from performance management and, in turn, drive meaningful, sustainable change throughout the company.

Financial institutions should focus on using performance management to support robust career paths that offer a wide variety of opportunities, offer recognition and differentiated (performance-based) rewards, and foster a culture of high performance and real-time feedback.

The millennial generation is on the move—increasingly to perceived greener pastures, where regulatory demands are lower and rewards, flexibility, and overall career growth may well be higher. Approached correctly, a strategic “performance adjustment” can be a game-changer for financial institutions struggling to attract, engage, and retain top talent in a complex, competitive market. It can also help financial institutions develop organizational capabilities and meet stakeholder expectations.

Where do we go from here? Quick tips to get you going

Here are our suggestions to help you on the path to a performance management “adjustment”:

1. Assess how your performance management practices measure up against our six recommendations.
2. Gather stakeholder feedback on your biggest pain points, as well as any opportunities for quick wins.
3. Determine your budget for making performance management “adjustments.”
4. Prioritize the findings from your assessment, so you can choose and then implement the key performance management “adjustments” that can deliver the greatest value to your organization.

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