

BREAKING BETTER

Is traditional performance management still fit for purpose? Or are agile new firms such as Netflix, which reject formal process, the way ahead? Morice Mendoza reports



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Breaking Bad's crystal meth lab was a global sensation for Netflix

If Walter White – the chemistry teacher-turned-drugs baron in the Emmy-winning TV series *Breaking Bad* – had been a technopolymath rather than a chemistry whizz, he might have invented Netflix instead of supplying crystal meth. But then the 10 million UK viewers who tuned in to see the final episode, up from 1.9 million for the previous series, would have been more than a little disappointed.

Instead it fell to the founder of Netflix, Reed Hastings, a computer engineer working in Silicon Valley, to discover the legitimate road to riches. He set up the company in 1997, basing it on the notion of renting out films by mail. And over the past few years, thanks to the arrival of internet streaming, it has become one of the world's most exciting broadcasters, transforming our TV habits by encouraging us to binge greedily on our favourite shows. So much so that following *Breaking Bad's* Emmy-award success, creator Vince Gilligan credited its streaming on Netflix with keeping the worldwide hit on air.

Last year, an innocuous-looking slide deck modestly entitled *Netflix Culture: Freedom & Responsibility* proved to be another provocative hit. But this one wasn't fictional. The slides outlined the company's approach to managing talent. It went viral, and has now been seen by more than eight million people – a total that's still rising.

Patty McCord, former chief talent officer at Netflix who co-authored the deck with Hastings, was initially surprised that such a sparsely designed set of slides could create such a stir. But, she believes, its appeal lies in its simple messages: forget processes and procedures; pack your company with the best performers; put them in teams; and create an environment in which they're inspired to pursue excellence. Maybe it was always that straightforward, and a century of HR practices and performance management procedures had over-complicated matters. Or maybe McCord is over-simplifying things.

In a January 2014 *Harvard Business Review* article, *How Netflix Reinvented HR*, McCord, now a consultant, reiterated the hard-hitting message: "If you're careful to hire people who will put the company's interests first, who understand and support the desire for a high-performance workplace, 97 per cent of your employees will do the right thing." The problem, she says, is that HR departments often spend a great deal of time devising policies and procedures to deal with the other three per cent.

In Netflix's single-minded world view, elements of performance management – in particular, appraisals – can be consigned to the landfill of bureaucracy. McCord believes that formal performance reviews are a waste of time, and prefers to get managers and employees to

engage in conversations about performance as an "organic part of their work".

Today, Netflix focuses on hiring people it can count on to deliver a set of nine particular 'behaviours' (judgement, communication, impact, curiosity, innovation, courage, passion, honesty, selflessness). The idea is to free staff from a web of form-filling. In return, the company expects its staff to motivate themselves in the pursuit of excellence. Treated like adults, those who fit into the culture excel, says McCord. But those who don't play to their best, don't fit in, or lack the skills needed as the company adapts, may also find that Netflix can bite. "Adequate performance," reads one of its simply designed slides, "gets a generous severance package."

In such an environment, people are trusted and expected to do what's needed. It's success that is valued. If you get there without great effort, fine. Poor performers, however, don't get any credit for hard work. As another slide puts it: "Sustained A-level performance, despite minimal effort, is rewarded with more responsibility and great pay." In contrast, B-level performance, no matter how great the effort, leads to the exit door.

This is no idle threat. In her *HBR* article, McCord mentions a finance employee, a top performer who, in the wake of the company's IPO in 2002, suddenly couldn't deliver the higher-level skills needed. She was given one of Netflix's generous severance packages before reinventing herself as a massage therapist.

Some may say such a relentless focus on A-level skills is heartless and, according to one response to the *HBR* feature, some ex-employees talk of a culture of fear. But many believe that something more profound is going on. Instead of relying on a process-driven system, Netflix's fundamentalist approach demands razor-sharp understanding – and delivery – of the skills and qualities it needs to succeed.

Is Netflix the way forward? CIPD chief executive Peter Cheese says it's a paradigm that has much to teach the rest of us. "Netflix has ripped up the old procedural rule books and said: 'Let's approach this much more from the fundamentals.' That makes sense," he says.

Nor does it suggest, argues Cheese, that Netflix doesn't value the human element: "It absolutely does value it, aligning behaviour with its values and the human traits it sets out." These include such qualities as courage, tenacity, candour and a willingness to share.

Netflix has a message for the HR profession, Cheese believes. It needs to look strategically at the nature, purpose and needs of the business. "HR hasn't done enough of this," he says. "It should be asking: 'What kind of capabilities do we need? What kind of culture are we trying to create? And what kind of organisational model do we need?'"

IDEO'S OPEN CHANNELS

The quality and frequency of conversations is key to keeping staff engaged, according to design company IDEO. Formal process is minimised and annual appraisals have been replaced by internal discussions.



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William Rogers, chief executive of UKRD – a media company that owns and operates 17 local commercial radio stations – agrees that you need to recruit people for their behavioural qualities as well as their skills. "We spend a huge amount of time, money and effort working on people's own characters and behaviours, probably more than we do on skills and training."

It's about teamwork, says Rogers, and it's quite straightforward: "If you have the right team and give them the right level of responsibility in an environment that lets them not only be themselves but grow as individuals, then you'll find that you've gained a lot of commitment that gives the business a massive discretionary dividend."

Ensuring you have high-performing individuals working collaboratively in teams is crucial to business success today, adds Michael Mankins, a senior consultant leading Bain & Company's organisation practice in the Americas. Where A-players are incentivised to work together you get a multiplier effect, he says. "The average Navy SEAL [of the US Navy's Sea, Air and Land teams] is 10 times more destructive than the average soldier on the battlefield. But if you team together 10 Navy SEALs, they'll be more than a hundred times as effective."

The old individualistic, 'rank and yank' performance management models, made famous by Jack Welch at GE in the 1980s and '90s, created the opposite effect, Mankins believes. At GE, managers were divided into the top 20 per cent, the middle 70 per cent and the bottom 10 per cent (who were subsequently fired). Mankins describes the counterproductive culture this tended to create: "When times were tough, people just waited around for the guy above to screw up and be fired so they could move

up. They wouldn't help out their superiors because there would be nothing in it for them."

In contrast, he points to the team-building strategy followed by Alan Mulally, Ford's soon-to-retire chief executive. "Compensation, reward and performance management is all about team performance," says Mankins. Last year, he says, Microsoft also recognised a need to change its performance management system from one that used forced ranking to rate its top people as individuals to one that assessed teams. Formerly, the last thing an A-player would want to do was work alongside another A-player, lest his or her star shine less brightly. Safer to surround yourself with lesser lights.

Doug McIldowie is group HR director for the 12,000 employees spread across the globe at GKN Aerospace. For him, the Netflix slides strike a chord. "Its approach to performance is a challenge for many companies," he admits, "but the idea that as a leadership team you must try to hire the best, develop the best, then let them get on with their job, is absolutely where we want to be."

So what can this Silicon Valley upstart teach companies such as GKN about performance management? Is it a matter of focusing on the hiring and firing?

"HR is often procedural-driven rather than process-driven, and performance management is a good example of that," says London Business School professor Lynda Gratton. She thinks a big part of the problem centres on trust: "A lot of HR practices work on the assumption that people can't be trusted." It's a self-fulfilling prophecy and people behave accordingly. "If you start with trust, you will have a healthier approach," says Gratton.

Trust is the basis of Netflix's assertion that people should be treated as adults. For example, the company →

BEST BEHAVIOUR

Character and behaviour count for more than skills and training at UKRD, a media company with 17 local radio stations. The approach is compressed into six key terms: open, honest, fair, fun, professional and unconventional. Personal development plans have their place, but don't just focus on skills.



Kelly Bond Photography

neither tracks the number of days holiday staff take nor imposes a maximum number.

“The notion that you value output rather than input – what you achieve rather than how many hours you clock in – makes perfect sense,” says author and former start-up entrepreneur Margaret Heffernan. But she is less sure about the all-stars hiring approach. Heffernan's latest book, *A Bigger Prize*, argues that the Western obsession with the competitive instinct is often counter-productive. In this light, she is unsure that pulling together teams of superstars is really the most effective way to build winning teams. “The idea of A-players and B-players is unhelpful. How well people perform is as much a function of how they're treated as what they bring to work.”

Instead, she says, you may need to enmesh a mix of types, including, critically, the communicators who glue organisations or teams together. “High-performing teams are not just an aggregation of outstanding soloists. This is really important. People think you build high-achieving teams by gathering up a load of superstars and putting them together, or by having one or two superstars who somehow miraculously drag the rest up to their level.” In fact, she insists: “Many high-performing teams are characterised more by the communication between them than by their individual excellence.”

Music is a better analogy than sport, she thinks. “One of the things you find in bands or jazz ensembles, for example, is that the music actually improves when there's eye contact; in other

words, it isn't just about what the individual is doing, it's about the communication between all of them.”

In a culture of one-upmanship, she says, the result is that companies get rid of their communicators – classed often as B- or C-players – whenever things get tough. The result, she says, can damage performance. “Much of that work is invisible and quite hard to measure. Yet, they're always the first to get thrown out. Then companies wonder why they can't get anything done.”

If there's a growing momentum behind the idea of measuring team rather than individual performance, some believe that performance-related pay for individuals is also becoming discredited. “It's probably one of the worst ideas ever invented. There's no evidence that it works,” says Heffernan.

One of the issues, says Mankins, is that the processes required provide lots of data but little insight. A Bain project with the University of California, Berkeley, offers an example. Out of 13,000 employees, only seven were rated as indicating they didn't meet expectations. “They all filled out forms but the quality of the information wasn't very high,” says Mankins. There's additional pressure too, he notes, on developing the appropriate performance management system for Generation Y.

“Pay matters but isn't nearly as important to them as having an impact on the world, being part of an organisation that does things they're proud of, and being highly motivated and inspired by its leadership,” says Mankins. “So regardless of what you do on performance management, you still have to

“We have this principle of guided mastery. You've always got something to learn, but you also have something to teach”

figure out how to reward great performance, and that's changing with the new generation of talent.”

Sally Spinks, head of organisational design for the London office of design consultancy IDEO, explains how it introduced a new, simplified performance management process and grading system that staff found easier to follow. “We wanted to provide more clarity and to move from it feeling like a process to being about the quality of the conversation,” she says.

The old grade structure has morphed into four roles – individual, team, portfolio and enterprise – representing the potential career path from being, say, an individual designer all the way to becoming a senior manager. Instead of annual appraisals, IDEO favours informal and regular conversations between the individual and someone senior in their team. On an annual basis IDEO encourages people to seek feedback from those who have worked with them, and to record the outcome in brief one-liners. IDEO also emphasises the value of knowledge sharing. “We have this principle of guided mastery. You've always got something to learn, but you also have something to teach,” says Spinks.

At UKRD, six core values – open, honest, fair, fun, professional and unconventional – are a cornerstone of performance management. The culture encourages people to take responsibility for themselves – for instance, developing a process called ‘courageous conversations’ to enable staff to resolve issues among themselves. “Most problems should be resolved directly between the people in the business and not require management intervention,” says Rogers. “Often they aren't resolved because people won't talk courageously to each other.”

There is still a place for appraisals at UKRD, which Rogers calls “personal development plans... Appraisals are too process-driven. They're about what's good and bad about someone, usually focusing on skills and not the person. It's important to take the extra effort to help the person develop and not to just discuss their skills.”

Process is part of life at UKRD, but, says Rogers: “It isn't just about having the processes that matters. It's which parts of that process are relevant, how they are introduced and managed within the business, and ensuring they never run contrary to the philosophical way you approach your business.”

Where does all this leave the HR function in its efforts to drive good performance? While it is undoubtedly a therapeutic slap in the face for the traditionalists, the Netflix model may prove to be a step too far for many organisations. But the interest it has provoked should at least prompt other, more traditional businesses to take another look at their own processes if the outcome could be a more productive workforce. After all, Netflix ended the first quarter of this year with more than 48 million global members, and topped \$1bn in quarterly streaming revenue. It must be doing something right. **W**

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MANAGING TALENT THE NETFLIX WAY

Netflix's recipe for success is no mystery. It's a blend of common sense, communication, candour and respect

THERE'S A DIFFERENCE between what companies say they value and what they actually value, as demonstrated by those who get promoted, rewarded or dismissed. Enron (then led by CEO and chairman Kenneth Lay, right) had the values ‘integrity, communication, respect and excellence’ displayed in its lobby.

NETFLIX VALUES honesty and candour, exemplified by employees' willingness to admit mistakes quickly and only say things about colleagues they would say to their face. For leaders, this means no one in their group should be materially surprised by their views.

MANY COMPANIES like to espouse the team values of professional sports. Netflix, too, prefers team values to family ones, but admits the professional sports team analogy isn't perfect as it implies internal competition for a limited number of places.

RESPONSIBLE PEOPLE thrive on, and are worthy of, freedom. But companies, as they grow, often introduce processes that curtail such freedom. Netflix, says CEO Reed Hastings (right), recognises this difficulty and tries to increase employee freedom, believing self-discipline and informality appeal to high-performing talent.

MANAGERS SHOULD manage through ‘context’, not ‘control’. While ‘context’ involves defining goals that inspire staff, in a ‘control’ environment top-down decision-making prevails and planning and process are valued more than results. High-performance staff work better when they understand the context.

A KEY TEST for Netflix managers is: what does it take to keep star employees? Where pay is concerned, Netflix always seeks to pay top-of-the-market rates to high performers. External market value is a better measure of pay than internal parity. People whose skills are highly valued in the marketplace will win increased pay faster than those whose skills are less valued. Employees are encouraged to understand their market value by interviewing with or talking to competitors.

Source: Edited highlights from Netflix Culture: Freedom & Responsibility



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