

# Values-Exchange Leadership®: Using Management by Objectives Performance Appraisals to Improve Performance

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## Abstract

A leadership process is proposed which can be used in conjunction with Management by Objectives (MBO) performance appraisal. Leadership is viewed as the trading of values by managers which subordinates deem important in exchange for results-based subordinate performance satisfying to managers. In addition, the paper reports the percentage of Fortune 1000 companies using Management by Objectives (MBO) nearly tripled from 27 percent in 1981 to 79 percent in 2008. Companies using Behaviorally Anchored Rating Scales (BARS) doubled from thirteen to 26 percent while the percentage of companies using Graphic-rating Scales declined about one-third from 46 to 30 percent. Subordinate-ratings of Supervisory Performance were used by eleven percent of the companies as was Forced Distribution.

## Introduction

Many companies offer some method or combination of methods of employee performance evaluation. Appraisal of employee performance is believed helpful for productivity improvement and organization effectiveness (Bohlander & Snell, 2007). In addition, appraising performance is part of leadership as summarized by Bernard Bass (1990).

When I first began consulting, subordinates I interviewed repeatedly asked me, “What do I get out of it (recommended changes)?” My response was and still is to attempt to elicit some kind of benefit(s) trade between subordinates and managers in which subordinates receive something valued by them in exchange for some kind of objectively-measured organizationally-desired performance improvement. Most of the time, the exchange does not involve giving more money to subordinates. Many times the rewards offered are psychological.

Many managers want increased productivity or quality or both from their subordinates. The question becomes how to accomplish that. I believe exchange theory provides the answer.

### **Social Exchange Theory**

Thibaut & Kelly (1959) were two of the first to offer a theory of social exchange and defined it as a process of interaction between two individuals resulting in rewards and costs. Interaction was defined as “emit behavior in each other’s presence, ...create products for each other, or ... communicate with each other.” (p. 10) Rewards were defined as “pleasures, satisfactions, and gratifications the person enjoys.” and costs “any factors that operate to inhibit or deter the performance of a sequence of behavior.” (p.12)

Hollander and Julian (1969) applied social exchange to leadership proposing a theory of rewards exchange between leaders and followers. Jacobs (1970) was even more explicit in his description of social exchange stating, “Leadership is an interaction between persons in which one presents information of a sort and in such a manner that the other becomes convinced that his outcomes (benefits/costs ratio) will be improved if he behaves in the manner suggested or desired.” (p. 232) “...leadership is a transaction ....” (p. 233)

Hollander (1978) added “When leaders are effective, they *give* something and *get* something in return. This social exchange, or *transactional approach* to leadership, involves a trading of benefits.” (p. 7) Consistent with Hollander, Burns (1978) used the term “*transactional leadership*” writing:

Such leadership occurs when one person takes the initiative in making contact with others for the purpose of an exchange of valued things...economic or political or psychological in nature: a swap of goods or of one good for money; a trading of votes between candidate and citizen or between legislators; hospitality to another person in exchange for willingness to listen to one’s troubles. (p. 19)

### **Transformational and Transactional Leadership**

Burns (1978) distinguished transactional from “transforming” leadership which occurs when “leaders and followers raise one another to higher levels of motivation and morality.” (p. 20) Bass & Riggio (2006) further clarified the difference between the two concepts stating:

Transformational leadership is in some ways an expansion of transactional leadership ... based on the leader discussing with others what is required and specifying the conditions and rewards these others will receive if they fulfill those requirements. Transformational leadership ... involves inspiring others to commit to a shared vision and goals for an organization or unit, challenging them to be innovative problem solvers, and developing followers' leadership capacity via coaching, mentoring, and provision of both challenge and support. (p. 4)

I submit that Burns and others' transactional exchanges and transformational elevations are merely social exchanges in dissimilar forms. I believe that transformational inspiration, challenges, and development are what some followers want in exchange for various benefits those followers are willing to trade. For example, Bass & Riggio (2006) point out that "Contingent reward is transactional when the reward is a material one, such as a bonus. Contingent reward can be transformational, however, when the reward is psychological, such as praise." (p. 8). Subordinates seek rewards from managers no matter what form those rewards take in exchange for benefits they are willing to trade.

### **Performance Appraisal Methods**

Performance appraisal can be used as a tool of leadership to elicit increased productivity and/or quality from subordinates. Various methods of performance appraisal are used by organizations (Bohlander & Snell, 2007). The desire to find out what kinds of performance appraisal methods were in use in private enterprise, more specifically in Fortune 1000 companies, was motivated in part by the fact that private enterprise is responsible for about 80 percent of the total U.S. Gross Domestic Product (GDP). Federal, state, and local government is responsible for the remaining 20 percent (BEA.gov, 2009a). GDP "measures the value of final goods and services produced in the U.S. in a given period of time." (Gutierrez, C., Glassman, C., Landefeld, J., & Marcuss, Rosemary, 2007, 2). In 2007, GDP reached \$13.807 trillion (BEA.gov, 2009b).

Although performance appraisals in the public sector can sometimes encourage increased motivation to be more productive at a higher-quality level, some people who have worked in both private enterprise and government organizations believe performance appraisals differentiating between levels of performance are more rigorous in private enterprise (Welch, 2007). Some government organizations such as agencies of the Federal Government possess outdated performance appraisal systems with inadequate accountability for performance (Else, 2002).

The Fortune 1000 is a compilation of the largest-revenue public and private incorporated companies in the United States (U.S.) which file documents with government agencies and

some companies owned by private domestic or foreign companies which do not file financial statements with a government agency (*Fortune*, 2008). The 2008 Fortune 1000 earned revenues of \$11.975 trillion in 2007 (*Fortune*, 2008, CNNMoney.com, 2009). All of the major industry groups in the U.S. economy contain Fortune 1000 companies.

Because Fortune 1000 companies are the largest organizations in the private sector, they have more resources to expend on performance appraisal in comparison to smaller companies. The greater resources of Fortune 1000 companies allow them to hire more staff who can devote more time to the performance-appraisal administration and to study the most-recent performance-appraisal information available. Many times Human Resources (HR) representatives from Fortune 1000 companies are presenters at HR conferences, workshops, and other professional gatherings where new ideas in performance appraisal are discussed in the marketplace of ideas and disseminated into the world of organizations. In addition to all of the reasons stated previously, I wanted to discover if there had been any significant change in the types of performance appraisal used by Fortune 1000 companies in the past quarter century in a longitudinal study replicating part of a previous research effort.

Herbert Chrudden and Arthur Sherman (1984) had listed a number of performance evaluation methods which included rating scale, behaviorally anchored rating (BARS), essay, management by objectives (MBO), checklist, forced-choice, work-standards, ranking (forced distribution), and critical incident. I was particularly interested in MBO because of its more-objective, results-based orientation, the fact that George Odiorne's (1965) MBO cycle has been included in human resource management textbooks to this day (Bohlander & Snell, 2007; Hersey & Blanchard, 2007) and because Rodgers and Hunter (1991) had found MBO increases productivity.

In terms of performance appraisal, Ruth and Brooks (1982) found MBO to be "alive and well" in a sample of "Fortune 500 sized organizations ... in "several of the major industry groups." Likewise, O'Donnell and O'Donnell (1983) stated in "answer to the question: 'Is MBO passé? No!'" 79% were using MBO for "performance appraisal or performance planning and review." However, their 1981 sample was drawn from industrial, utility, transportation, financial, insurance, and merchandising companies located in Southern California only.

In 1981, Taylor and Zawacki (1984) mailed a questionnaire to a random list of 200 Fortune 1000 companies. Eighty four of the firms responded: nine with employees numbering less than 1,000 (eleven percent); 63 with 1,000-5,000 employees (75 percent), and twelve with more than 5,000 employees (fourteen percent). The Fortune 1000 in 1981 (Worthy, 1981; O'Reilly, 1981) listed 31 companies with less than 1,000 employees (three percent), 428 with 1,000-5,000 (43 percent), and 537 with more than 5,000 (54 percent). Employee counts for four companies were listed as not available.

Taylor and Zawacki (1984) found 39 of the 84 Fortune 1000 companies responding to their survey used a Graphic-rating scale (46 percent), 23 used Management by Objectives (MBO) (27 percent), eleven used a Behaviorally Anchored Rating Scale (BARS) system (thirteen percent), and six had no performance appraisal system (seven percent). No response totals for

Peer rating (Subordinate-ratings of Supervisory Performance) or Forced-distribution were reported.

Locher & Teel (1988) reported that the prevalence of MBO as a performance appraisal technique had increased from 13 to 18 percent from 1977 to 1987. Fifty-seven percent of their sample reported using graphic-rating scales while 21 percent used essay performance appraisals. Locher & Teel's sample was drawn from Personnel and Industrial Relations (PIRA) organizations in five counties of Southern California. Only 36 percent of the organizations had 500 or more employees.

Bretz, Milkovich, & Read (1990) surveyed Fortune 100 companies and found MBO performance appraisals to be the most common form of appraisal used with 31 percent using it for non-exempt-employee performance evaluations and 70 to 83 percent of the organizations reporting its use for exempt managers and professionals. Sixteen to 31 percent of organizations used graphic-rating scales and fourteen percent used BARS.

In their study, Smith, Hornsby, & Shirmeyer (1996) found 31.8 percent of companies used MBO while narrative essay and graphic-rating scales were used by 33.9 and 24 percent of the companies respectively. Smith, et al.'s sample was drawn from Society for Human Resource Managers (SHRM) managers in smaller companies located in the Midwestern U.S. Only 49 percent of the companies had 501 or more employees.

### **2008 Fortune 1000 Performance Appraisal Methods Study**

Taylor & Zawacki's (1984) 1981 survey of Fortune 1000 companies exclusively consisted of standardized response categories in a questionnaire which applied definitions that appeared to be succinct, clear and comprehensive in accordance with a popular human resource textbook of the times (Chruden & Sherman, 1984) now in its 14<sup>th</sup> edition (Bohlander & Snell, 2007). I decided to use their definitions for my survey.

In July and August of 2008, a questionnaire with a self-addressed stamped envelope was mailed to 800 random Fortune 1000 companies in an attempt to ensure a response comparable to the 1981 study. About one week after mailing, phone calls were made to ensure the questionnaires had been received, to answer any questions about the study, and to encourage participation. In some cases, the survey was communicated verbally or e-mailed a second time. Although their definition titles were not used, Taylor and Zawacki's (1984) definitions were used in the questionnaire which follows.

“Please place a check-mark on the line(s) below to the left of the type(s) of performance appraisal you use and return in the self-addressed stamped envelope enclosed for your convenience.

- A process consisting of a series of steps with joint goal setting, action planning, self-control and periodic progress reviews.
- Subordinates rate the supervisor's performance.
- Rater and employee develop core job dimensions and behaviors with a scalar rating of levels of job performance.

- \_\_\_\_\_ Rater places a check-mark on the form next to the word describing the degree of merit for each of several different traits or behaviors.
- \_\_\_\_\_ Employees are ranked in a pre-determined distribution along one or more scales and a fixed percentage of employees are assigned to each quartile of the scale.
- \_\_\_\_\_ None.” (p. 72).

The 2008 Fortune 1000 contained six companies in the standard-industrial code major industry group of agriculture, forestry and fishing. Fifty-eight companies were engaged in mining, 164 in construction, 199 in manufacturing, 137 in transportation, communication, electric, gas, and sanitary services, 163 in wholesale trade, 160 in retail trade, 83 in finance, insurance, and real estate, and 30 in services (CNNMoney.com, 2008; Hoover’s, 2008; LexisNexis Academic, 2008; Mergent Online, 2008). One hundred twenty five companies responded to the survey. Two companies were classified within the standard industrial codes designating the major industry group of agriculture, forestry, and fishing, seven were in the mining major industry group, 23 in construction, 20 in manufacturing, 24 in transportation, communication, electric, gas, and sanitary services, 20 in wholesale trade, eighteen in retail trade, eight in finance, insurance, and real estate, and three in services. Table 1 shows a comparison of percentages of sample responses by industry to the total population by industry to indicate the degree of representativeness of the survey sample in comparison to all of the Fortune 1000 companies. The lower the degree of discrepancy between the survey sample and the total population, the greater the degree of representativeness of the survey sample to the total population (Kerlinger, 1986).

Table 1  
2008 Fortune 1000 Sample Compared to Population by Industry  
Expressed as Percentage

| Industries  | Sample | Population | Difference Between Sample and Population |
|---|--------|------------|--|
| Agriculture, forestry, and fishing                                  | 2      | 1          | + 1                                      |
| Mining  | 6      | 6          | 0  |
| Construction  | 18     | 16         | + 2                                      |
| Manufacturing   | 16     | 20         | - 4                                      |
| Transportation, communication, electric, gas, and sanitary services | 19     | 14         | + 5                                      |
| Wholesale trade   | 16     | 16         | 0  |
| Retail trade  | 14     | 16         | - 2                                      |
| Finance, insurance, and real estate                                 | 6      | 8          | - 2                                      |
| Services  | 2      | 3          | - 1                                      |
| Total   | 99     | 100        |  |

Note: Sample percentage totals 99 due to rounding.

The 2008 Fortune 1000 listed 31 companies with less than 1,425 employees, 429 with 1,425-11,700, and 532 with more than 11,700. Employee counts for eight companies were listed as not available. Of the 125 survey respondents, three companies had employees numbering less than 1,425; 69 had 1,425-11,700, and 53 numbered more than 11,700 employees. Only one, twelve, and eleven percentage-point differences were achieved in the < 1,425, 1,425 – 11,700, and 11,700 > ranges respectively. Table 2 shows a comparison of percentages of sample responses to the total population by employee size to indicate the degree of representativeness of the survey sample in comparison to all of the Fortune 1000 companies in accordance with accepted sampling theory (Kerlinger, 1986).

Table 2  
2008 Fortune 1000 Sample Compared to Population by Employee Size  
Expressed as Percentage

| Employee Count Range | Sample | Population | Difference between Sample and Population |
|----------------------|--------|------------|--|
| < 1,425              | 2      | 3          | - 1                                      |
| 1,425 – 11,700       | 55     | 43         | + 12                                     |
| 11,700 >             | 42     | 53         | - 11                                     |
| Not Available        | 0      | 1          | - 1                                      |
| Total                | 99     | 100        |  |

Note: Sample percentage totals 99 due to rounding.

In 2008, 99 of the organizations responding used MBO, 38 used a graphic-rating scale, 32 used a BARS system, fourteen used subordinate-ratings of supervisory performance, fourteen used forced-distribution, and six reported “None.” Companies used an average of 1.62 methods.

A dramatic difference was found in the usage of MBO, BARS, and graphic-rating reported in 2008 as compared to 1981. Table 3 shows the 2008 survey results expressed as a percentage in comparison to that of 1981.

Table 3  
2008 Fortune 1000 Sample Compared to 1981 by Performance Appraisal Method  
Expressed as Percentage

| Performance Appraisal Method | 2008 | 1981 | Difference |
|------------------------------|------|------|------------|
| MBO                          | 79   | 27   | + 52       |
| Graphic-rating               | 30   | 46   | - 16       |
| BARS                         | 26   | 13   | + 13       |

|   |       |      |     |
|---|-------|------|-----|
| Subordinate-rating of Supervisory Performance | 11    | NA   |     |
| Forced Distribution                           | 11    | NA   |     |
| None  | 5     | 7    | - 2 |
| Number of companies responding                | (125) | (84) |     |
| Average number of methods used per company    | 1.62  |      |     |

Note: Percentages for 2008 add to more than 100% because companies reported using more than one method.

Numbers in parentheses are *N*s.

Decimal number is average number of methods reported per company.

### Values-Exchange

Measuring traits or characteristics as is the case with Graphic-rating scales or behaviors in the form of BARS is more vague and subjective than MBO which is more objective and empowering (Bohlander & Snell, 2007). Graphic-rating and BARS methods are normally more one-way processes from managers to subordinates and subject to differences in perception by both. Those two characteristics alone work against facilitating the free flow of communication and, by definition then, against social exchange.

In the Graphic-rating method, subordinates' traits or characteristics are subjectively rated by managers on a scale from worst to best and in BARS, subordinates' job behaviors are subjectively rated. Although, Bohlander & Snell (2007) reported BARS has been found to yield more-accurate ratings than Graphic-rating scales, neither are as objective, as good for reward and promotion, encourage manager and subordinate mutual goal setting, and link individual performance to organizational performance (Bohlander & Snell, 2007).

As indicated before in referencing Thibaut & Kelly (1959), social exchange involves "costs" which "inhibit or deter...performance." (p.10) Surely, any method of performance appraisal which by its very nature is not as conducive to two-way communication and participative leadership as MBO will be considered more of a "cost" by subordinates and limit social exchange between managers and subordinates. When managers and subordinates are both involved in the formulation of the objective measures by which subordinates will be evaluated, the stage can be set for better communication and social exchange.

Since MBO results-based performance appraisal is the most-commonly used form of performance evaluation used by Fortune 1000 companies wherein managers and subordinates engage in a step-by-step process of joint goal setting, action planning, self-control and period progress reviews, I recommend using a MBO-based values-exchange leadership process to improve subordinate performance and leadership effectiveness.

Many of the performance-appraisal forms I have seen are one-way with little or no commitment from managers as to what they personally are going to do or have done in exchange for results desired or achieved by their subordinates. In addition, some authors like Scott & Einstein (2001) and Gregersen, Hite, & Black (1996) have pointed out the



deficiencies of using standardized performance-appraisal forms for large companies possessing varied organizational structures and far-flung geographical locations.

I recommend use of a simple, two-way MBO type of process in which the person appraised and the manager who rates agree on what they are going to exchange to each other for the purpose of achieving desired subordinate performance. Sometimes, the manager is not willing or is unable to give subordinates what they want. In that case, negotiation begins until a final agreement is reached.

From the subordinate side, values-exchange leadership is similar to MBO which was first proposed by Drucker (1954) and enhanced, modified, and operationalized by Odiorne (1965) and Humble (1967). Subordinates provide input to managers. Managers then decide which goals and quantitative and/or qualitative time-phased, achievable, specific outputs the subordinates will attempt to achieve implementing agreed-upon necessary activities utilizing agreed-upon resources and being evaluated periodically with accurate, relevant, and timely performance measures. Subordinates use MBO as the control mechanism instead of managers and modify their behavior and goals accordingly as a result of the periodic progress reviews.

It is the managerial element of the social exchange process which departs from MBO in the implementation of Values-Exchange Leadership. Dansereau, Alutto, and Yammarino (1984) reported that subordinate performance which is satisfying to managers is an outcome of the social exchange of benefits first provided by managers. Although managers should see the best results if they trade benefits first, they should decide what results they want subordinates to accomplish and subsequently ask subordinates what they want in return.

This exchange negotiation process need not take a long period of time nor a great deal of preparation. Some of the most effective agreements I have heard resulted in response to a simple question, "What's it going to take?" The most common answer I hear initially when I ask people what they want in exchange for increased productivity or quality is "more money." However after probing for varying lengths of time, it has been my observation (Curtin, 1988) and that of others like Dansereau, Alutto, Nachman, Al-Kelabi, Yammarino, Newman, Naughton, Lee, Markham, Dumas, Kim, and Keller (1995) and Dansereau, (1995) that most subordinates want self-esteem support from managers in whatever form that may take.

The critical component of the values-exchange leadership process is the identification of what subordinates truly want from managers. According to Milton Rokeach (1973), values are goals and conduct which are important to people and believed to be good, bad, right, and wrong. Many times these values are subconscious. (Harre', R. & Lamb, R., 1983). Values are outcomes.

According to Victor Vroom (1964) who is given credit for proposing expectancy theory, subordinates' motivation, ("force to perform an act"), is equal to the degree of intensity of a desired value, ("valence of outcome"), multiplied by the belief that a desired outcome will result after the act is performed, ("expectancy that an act will be followed by the outcome").

(p. 27) Robbins & Coulter (2003) and Dessler (2001) reported most research supports expectancy theory and Hellriegel, Jackson, & Slocum (2002) reported the theory is widely-accepted.

Expectancy theory is the foundation of path-goal leadership first proposed by Evans (1970) and later expanded upon by House (1971), House and Dessler (1974), and House and Mitchell (1974). Specifically, Evans (1970) stated leaders' effectiveness in part would be enhanced by leaders administering "need" rewards as well as punishments to subordinates ensuring that subordinates perceived those rewards and punishments as being contingent upon subordinate behavior. Consistent with social exchange theory, Evans proposed that "need" rewards such as compensation, job security, promotion, and social and esteem should be awarded "selectively" consistent with subordinates' "individual desires." (p. 282)

Bass (1990) termed path-goal leadership an "exchange theory of leadership" (p. 627) and reported the theory had accumulated "a considerable amount of general empirical support." (p. 628) Both Daft (2008) (p. 504) and Robbins & Coulter (2003) stated path-goal theory research-validation was "encouraging" with the latter adding that more than half of the research supported the logic of the theory. (p. 470)

In his publication, Vroom (1964) wrote that people may work because it affects their social status or acceptance by other people to achieve the values of "social acceptance and respect" whereas not working might result in "social rejection and disapproval." (p. 42) When managers can identify what their subordinates truly want in the way of self-esteem support and enhancement and more importantly are motivated to help subordinates achieve and live those values, subordinates will be more likely to deliver productivity and quality to the satisfaction of their managers.

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