

Claremont Graduate University

Course: Drucker on Management 343

Analysis of Lincoln Electric's Performance Development System

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Lincoln Electric, the world leader in welding and cutting products, owes much of its success to its dedicated, talented workforce. People are Lincoln's fundamental advantage, and the source of its superior market position, giving in nearly \$1.2 billion in sales. Accordingly, Lincoln Electric pays considerable attention its employee review and rewards control system. Their Performance Development System (PDS) embodies much of Peter Drucker's advice regarding management by objectives (MBO), management by self-control, and the spirit of performance. According to Drucker, "An organization that wants to build a high spirit of performance recognizes that 'people' decisions ... are the true 'control' of an organization," because people decisions signal what the organization really wants, values, and rewards (*Management: Tasks, Responsibilities, Practices*, p. 460).

Effective October 1, 1997, two versions of the Performance Development System went into effect, one for all salaried employees and the other for most hourly employees. The remaining pieceworker and production hourly employees continued to use the Merit Rating System. The PDS was introduced for two reasons. The first was to better align individual performance with Lincoln's strategic plan. The second reason was to fulfill the request of employees who felt that the structure of the Merit Rating System did not reflect the work that many employees performed. The strengths of PDS is that it develops expectations that support

individual goals, and then measures progress towards those goals. This gives employees and managers logical checkpoints, and methods to receive and give feedback. This process has many integrative benefits (goal alignment with corporate strategic plans) as well as the very practical opportunity for employees to change course if necessary. No one has to wait until the end of a review period to discover that he or she has not performed as expected. The limitations of PDS include the second step of performance coaching, an informal process of performance and development monitoring that may not be documented. As we will discuss, this step creates the potential for ambiguity. Another concern with PDS is with the fourth step of performance review, and the potential problem that the self control and performance standards may be too steep. Overall, the PDS follows Drucker's seven specifications for giving managers control, including having controls that are economical, meaningful, appropriate, congruent, timely, simple, and operational. Accordingly, we would argue that Lincoln Electric's Performance Development System is effective and follows the advice contained in Drucker's *Management: Tasks, Responsibilities, Practices* as well as any real world application of an ideal management model.

Lincoln's success in managing its employees comes in a large part from the Performance Development System's reinforcing the philosophy of management by objectives (MBO). It gives empowerment to individual strength and responsibility. PDS gives a common direction to Lincoln's vision and establishes team work. It synchronizes the goals of Lincoln with that of the individual employee. PDS enables control from the inside, and motivates a manager to action because the objective task demands it. This in turn ensures performance by converting objective needs into personal ones, giving genuine freedom to the employee. It also acknowledges that

Lincoln has to prepare its people for tomorrow's work. Otherwise they "... would be training people as apprentices under their present bosses and hope that they learn what their present bosses know and do" (*Management: Tasks, Responsibilities, Practices*, p. 424).

The first step of the Performance Development System is setting goals. Drucker states that in order to effectively manage by objectives and self control, "Each member of the enterprise contributes something different, but all must contribute towards a common goal" (*Management: Tasks, Responsibilities, Practices*, p. 430). There needs to be an integrative effort where individual goals pull in the same direction to produce a whole. But to do this, employees need to know what the business goals demand of them in terms of a personal contribution. Lincoln Electric describes these contributions as competencies that fit the nature of an employee's work, and labels them specific performance expectations (SPEs). Employees have several competencies assigned to them, and more than one competency may be unique to their jobs.

Salaried employees' performance plans also include individual performance goals. These goals are the "to do list" of what they will accomplish during the year. These goals are set at a realistic number of between three to five, with the important caveat that they are clearly tied to the department's business plan. This fits Drucker's requirement that when an employee reaches his or her goals, he will also be helping his department meet its goals, which in turn should meet the corporate strategic plan. Lincoln's goals follow the acronym SMART. They are specific, measurable, attainable, relevant, and time-based. This follows Drucker's analysis in that goals should be accomplishable through clear tasks and activities, involve measurable results, be challenging but not impossible, and most importantly, contribute to the strategic goals of Lincoln Electric. In other words, objectives or goals must degenerate into work. It is important to note

that the objectives do not include profit. “Profit...is the result of doing things right rather than purpose of business activity” (*Management: Tasks, Responsibilities, Practices*, p. 98).

All employees on the PDS will have their competencies weighted. These weights define the relative importance of each competency, and can help employees and managers determine where the employee should place the most emphasis throughout the year. This fits Drucker’s philosophy of being effective, doing the right things at the right time in the best way, versus just being efficient, which doesn’t take into account doing the right things. Salaried employees will also have weights assigned to their goals, and for all employees the weights will total 100 points. For salaried employees, goals will total 40 to 60 points, with the remainder assigned to their competencies. No individual competency for salaried employees will be assigned more than 20 points, creating a balance between goals and competencies. Hourly employees have weights strictly on competencies (with no individual goals assigned). The more important a particular competency is for an hourly employee, the more points assigned, with no more than 30 points for any one competency. By definition, this means that all hourly employees must have at least four competencies (30, 30, 30, 10), and many would probably have more. This aspect of the PDS for hourly employees would encourage the development of many competencies, leading to a cross-trained and multi-talented hourly workforce. The first benefit of having a cross-trained workforce, is that it gives them the ability to hire from within, rather than look outside for new employees. A second benefit of having that kind of adaptability is when Lincoln has to handle a crisis or large project. For example, when Lincoln acquired its first U.S. company, it had to move the entire acquired company, all raw material and finished goods from two plants in downtown Cleveland, to the main plant on the outskirts of the city. Then it had to tear down two

factories and remove key equipment over the weekend with the precision of a military operation. Lincoln's people moved 9 truckloads of material per hour, compared to the acquired company that did 4 truckloads per day.

The Performance Development System's goal setting step fulfills Drucker's statement on the power and purpose of objectives. Objectives are derived from both the employee and supervisors thought processes. Objectives are operational and converted to specific work assignments. Objectives must concentrate resources and efforts, and the PDS does this by focusing on a limited number of competencies. There must be multiple objectives, and PDS takes into account personal (for salaried employees), department, and corporate goals. Finally, objectives must be specified in each area in which survival of the business depends. By aligning both salaried and hourly workers with their department goals, PDS fulfills this requirement.

The second step of the Performance Development System is performance coaching. Lincoln Electric strongly believes in developing a partnership between employees and their managers that commits them to achieve their performance plans while meeting corporate objectives. The performance coaching involves receiving personal feedback and recognition from an employee's manager, and in turn, providing feedback to an employee's manager about the tools needed for that employee to be successful. Those tools may be direction, support, the clearing of obstacles, or revising the performance plan. During this coaching process, employees will also receive corrective feedback discussing opportunities for improvement. Finally, employees are encouraged to discuss ideas for improving company performance. When performance and developing monitoring is most successful, it occurs on an ongoing and informal basis throughout the year. Unfortunately, a risk to this approach is that the informal basis has the

potential for ambiguity. We note that Lincoln Electric may be structured with a large span of control that requires informal interaction to solve problems. However, if managers or supervisors do not document the potential many informal interactions, there is the potential for misunderstanding. We are not arguing that every informal exchange be documented. That would be impossible. We do want to acknowledge the aspect that if the employee considers himself or herself to be on a perpetual feedback loop, some actions that the manager takes may be construed as an “exchange session” when in fact it was a singular incident. If managers are having a poor day, are in an angry mood, or are distracted with other thoughts, dialogue with employees may be taken as corrective feedback.

The third step of the Performance Development System is the interim review. An employee and his or her manager will meet at least once per year to discuss progress, and to evaluate how well he or she is living up to the responsibilities assigned. This interim review can be considered a preview of the performance evaluation, giving the employee invaluable feedback with time to change course if he or she is off track. By identifying performance issues that impact the successful achievement of an employee’s performance plan, Lincoln Electric has the advantage of not only keeping morale high, but ensuring that productivity never strays far off course. As Drucker says, MBO requires a special effort because in business organizations, managers are not automatically directed towards a common goal. To facilitate the message that this step is a time to improve, redirect, or reinforce progress, no formal ratings are administered during the interim review.

The fourth step of the Performance Development System is the performance evaluation and performance ratings. Annually, Lincoln Electric employees and their managers meet to

summarize and discuss job performance. They start with the development of job-related skills and competencies, focusing on the specific performance expectations (SPEs) and how they support the department business plan for that employee. Then they review personal growth and development opportunities. If the employee is salaried, the achievement of the three to five individuals goals is evaluated. This follows Drucker's belief that "An appraisal should be based on the performance objectives which a man has set for himself in cooperation with his superior. It should start with his performance against these objectives" (*Management: Tasks, Responsibilities, Practices*, p. 427). A considerable strength of this fourth step is that before meeting to discuss their evaluations, employees can self-assess their performance. This feedback "up" is shared with the employee's supervisor and becomes part of the evaluation process. Drucker says that mutual understanding can never be created by communications down. It can only result from communications up. This leads to Drucker's next important question: *What is the task?* By giving feedback, the employee helps to determine what he or she should be expected to contribute, what hampers that achievement, and what tasks should be abandoned. According to Drucker, asking these questions and taking action on the answers usually doubles or triples the knowledge worker's productivity.

There are five distinct performance ratings, including: *exceeds expectations*, *meets all expectations*, *meets most expectations*, *meets some expectations*, and *does not meet expectations*. A limitation of this fourth step is the stringent self control and performance standards. Their second-highest rating, *meets all expectations*, requires an employee do the following: 1) have a strong performance, 2) have met all expectations, 3) likely exceeded some expectations, and finally, 4) contributed to increased unit results. This strikes us as a likely optimum case for the

majority of employees. Certainly for employees that go the extra mile, more rewards can be granted. But this potential rewards rating system hints at being unattainable to get the best rating. Drucker indeed talks about building in stretch for employees, but again he states that goals should be doable. Added to this strict rating system are the assigned point system. *Meets all expectations*, by its definition mentioned above, seems like it should garner an excellent rating. By it only gives a baseline 1.0 multiplier. We feel this would discourage employees who truly excel and then earn a baseline reward. More so, employees who do have room for modest improvement will have more draconian multipliers of 0.8 and 0.6 respectively for *meets most expectations* and *meets some expectations*.

The fifth step of the Performance Development System is putting it all together. The point value of an employee's performance rating in each competency and goal (for salaried employees) is multiplied by the weighting assigned. The resulting calculation will be the total rating for each competency and goal. These totals are added together to obtain a summary rating for the review period. It is during this time when the employee and his or her manager will begin the process of developing the performance plan for the coming year. A strength of this fifth step is that it includes the input from the current evaluation along with the employee's department business plan to assist in developing the performance plan for the coming year.

Employees and managers both play an important role in the Performance Development System. Employees are encouraged to determine how they can best contribute to Lincoln Electric through performance on the job. Managers should be familiar with employees' job skills, strengths, and weaknesses, but employees should take the lead in discussing them. This is very much in line with Drucker's philosophy of knowing how you work. Drucker stresses the

importance of placing yourself, and this step is crucial for employees. They should know their skills, but if they don't know their strengths and weaknesses, they won't be able to say to a supervisor — "I prefer to work alone," or "I like group projects," or "this task works towards my strength." An important aspect of participating management, and a strong point of the PDS, is that both the employee and his or her manager have input to the progress and the evaluation. Finally, employees need to request feedback when they are unsure. They cannot wait until their interim review to ask, "Is this what I should be doing?"

The manager or supervisor is more than a skill rater. He or she is also a coach, which means helping employees manage their performance and developing their career in addition to providing a performance rating. Managers, by definition of their roles, should support the concept of the PDS and be committed to all of the steps. In addition, managers and supervisors should remain committed to the importance of a well thought out plan — as Drucker says when quoting the old Roman saying, every soldier has the right to competent command. Finally, managers should guide employees in developing clear expectations of not only their objectives, but also how they are doing in accomplishing them.

Human Resources at Lincoln Electric will implement the Performance Development System. Their first task is education and facilitation of the process by communicating information about each step. Next, human resources will coach supervisors and employees as they go through the process, providing formal training opportunities and the necessary resources to implement the PDS successfully. "In respect to human resources, for instance, it is highly desirable to have specific objectives for [managers], but also specific objectives for major groups within the non-managerial work force..." (*Management: Tasks, Responsibilities, Practices*, pp.

108-109). Finally, they will monitor the success of the process, as well as the outcomes, to be sure that the focus is truly on performance and development.

Lincoln Electric owes much of its success as a world class manufacturer of welding and cutting products to its exceptionally motivated and skilled workforce. Their Performance Development System (PDS) is a successful tool that embodies much of Peter Drucker's advice regarding management by objectives, management by self-control, and the spirit of performance. We note that "[compensation defines] a man's worth as much as his performances... For this reason, there can be no truly simple or truly rational compensation system" (*Management: Tasks, Responsibilities, Practices*, p. 434). And there are potential shortcomings in both the PDS second step of performance coaching (and the informal methods of performance monitoring), and the PDS fourth step of performance evaluations (that may have too stringent self control and performance standards). Still, we believe the merits of the PDS outweigh its limitations. The PDS fulfills its dual purpose of being able to better align individual performance with Lincoln's strategic plan and offering employees a better way to be appraised that more accurately reflects their work. The strengths of PDS is that it develops expectations that support individual goals, and then measures progress towards those goals. It creates integrative benefits that allow the organization's goals to be aligned with the individuals goals. Finally, when all parts of the organization work together successfully to achieve common objectives, all the stakeholders benefit. Customers, shareholders, and each employee share in the rewards of Lincoln Electric's good work. This aligns perfectly with Drucker's belief that "The purpose of an organization is to enable common men to do uncommon things" (*Management: Tasks, Responsibilities, Practices*, p. 455). Lincoln Electric seems to bring out whatever strength there is in their employees, and

helps reward them in a way that encourages each person to make their department, and in turn, the organization, perform. We conclude that their Performance Development System encompasses the spirit of performance.