Microsoft Abandons 'Stack Ranking' of Employ

Software Giant Will End Controversial Practice of Forcing Managers to Designa

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By SHIRA OVIDE And RACHEL FEINTZEIG CONNECT

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Microsoft Corp. MSFT -0.35% is abandoning major elements of its controversial "stack ranking" employee-review and compensation system, the latest blow against a once-popular management technique.

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The Redmond, Wash., software company said it would no longer require managers to grade employees against one another and rank them on a scale of one to five. The system—often called "stack" or "forced" ranking—meant a small percentage of Microsoft's 100,000 employees had to be designated as underperformers.

The rankings were a key factor in promotions and in allocating bonuses and equity awards under Chief Executive Steve Ballmer, who in August said he plans to retire within a year. But many current and former Microsoft employees complained the system resulted in capricious rankings, power struggles among managers, and unhealthy competition among colleagues.

Microsoft said Tuesday it is dumping the numerical rankings in favor of more frequent and qualitative employee evaluations. The change took effect immediately.

That makes Microsoft the latest in a series of companies to eliminate forced ranking, which was widely copied in the 1980s after rising to popularity at General Electric Co. GE -0.81% under Chief Executive Jack Welch. The system was often referred to as "rank and yank," because poor performers were encouraged to leave the company.

"Some think it's cruel or brutal to remove the bottom 10% of our people. It isn't," Mr. Welch wrote in his book, "Jack: Straight from the Gut." "There is no cruelty like waiting and telling people late in their careers that they don't belong."

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Ray Bartkus

But GE has moved away from its numerical review system under Mr. Welch's successor, Jeffrey Immelt. Mr. Immelt prefers reviews that candidly tell an employee where they are not measuring up and what they need to do to improve, without rigidly adhering to certain percentages.

Dick Grote, a Dallas-based performance-management consultant and author of a book about forced ranking, says the problem is partially the name, which conjures more negative associations "than almost any term in the business vocabulary."

Mr. Grote estimates that at least 30% of Fortune FT.T 0.00% 500 companies continue to rank employees along a curve, doing so under softer-sounding terms such as "talent management." For example, he says, a firm might mandate that only 10% of a supervisor's employees can rank in a top category and 2% must be in the bottom group.

While true stack rankings are becoming rarer, firms are looking for ways to add rigor to performance reviews and toughen up "easy graders" in their management ranks, says Mr. Grote, who works with large multinational industrial organizations.

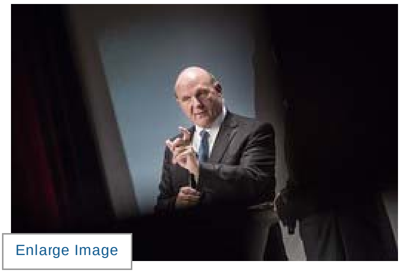
Insurer American International Group Inc. added forced rankings for thousands of its employees around 2010, in part to justify its compensation decisions to shareholders in the wake of the company's government bailout. In June, however, AIG Chief Executive Robert Benmosche made what he called "significant changes" to the process, giving managers greater flexibility in doling out ratings and exempting administrative assistants from the curve.

Some companies are trying a performance review scheme asking managers who oversee similar groups to review one another's employee-performance ratings. The practice, called "calibration" is becoming "wildly popular," and often results in managers regrading their workers, according to Mr. Grote.

In the technology industry, some companies have struggled with how to reshape employee-evaluation programs as they grow from startups to global titans. Amazon.com Inc., AMZN +2.97% Dell Inc. and Cisco Systems Inc. CSCO -10.92% each uses elements of the bell-curve employee ranking in their worker-review programs.

"It's a challenge today for large tech companies to figure out how best to assess and reward employees in light of slowing growth while still retaining the best talent who are best able to thwart the impact of disruptive technologies," said Charley Geoly, managing director with executive-recruiting firm Russell Reynolds Associates Inc.

Microsoft had used stack ranking for decades, though it has been revised several times. A company spokesman couldn't specify when the program begun. The spokesman wouldn't disclose the percentage of employees who had to be given each grade.



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Microsoft CEO Steve Ballmer. *Zuma Press*

In place of the numerical-ranking system, Microsoft managers now will give employees more frequent feedback on how they're performing. Managers also will have more flexibility in how they dole out bonuses.

The revamped system shows how Mr. Ballmer continues to reshape the company's strategy and culture in his waning months at the helm. Since the summer, he has pushed through a sweeping corporate reorganization and struck a strategy-reshaping deal to buy Nokia Corp.'s NOK1V.HE +1.20% mobile-phone business.

Lisa Brummel, Microsoft's executive vice president of human resources, said in an interview that Mr. Ballmer isn't tying his successor's hands. "The CEO may come in and say, 'You guys made the wrong decision,' " she said.

Ms. Brummel said the review system was overhauled in part to reflect an emphasis on teamwork in Mr. Ballmer's new strategy, and she said Microsoft can't wait for its next CEO. "We're aligning these [human resources] programs with what we're trying to do as a company," Ms. Brummel said.

Ms. Brummel said not all employees or managers embraced the old review-and-compensation system. She said the changes were based on feedback from more than

10,000 workers and interviews with more than 50 senior executives.

Tech recruiters say Microsoft is known for fairly rich employee compensation. It is unclear whether Microsoft is having trouble hanging onto employees or recruiting new ones, but some workers say anxiety is high now because of shifting responsibilities under Mr. Ballmer's revamped structure, questions about a new CEO's priorities, and how Microsoft will integrate Nokia.

Samuel Culbert, a professor at UCLA's Anderson School of Management, said annual reviews are a misuse of management's time, and are long overdue for a yanking at companies like Microsoft.

"The boss's job is not to evaluate," he says. "The boss's job is to make everyone a five."

—Kate Linebaugh
contributed to this article.