ARE SMALL BUSINESS OWNERS USING PERFORMANCE APPRAISALS TO THEIR FULL POTENTIAL? AN EXPLORATORY STUDY

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ABSTRACT

Recent articles have discussed the importance of the effective use of performance appraisals and creative ways that corporate America is using these tools to increase their managerial effectiveness. However, the study of the actual use of performance appraisals in small businesses has received little attention. This exploratory study examines the appraisal process within these organizations. Small business owners were randomly surveyed to discover who did the appraisals, how frequently they were done, what dimensions were deemed important, and what corrective actions were taken by the employer. Findings suggest that while small business owners realize that they should conduct some type of employee evaluation, they do not see the importance of incorporating a formal evaluation process into their management strategy. Guidelines are proposed for small business owners for the effective use of performance appraisals.

INTRODUCTION

In today's competitive environment, companies are continually looking for ways to increase their competitive advantage. One of the major ways to accomplish this task is through increasing productivity. After adopting and achieving the benefits of new technology, the only way to increase output is by increasing the productivity of the human resources, the employees. Small business owners often lack the cash flow to even purchase the latest technology. Therefore, if they want to remain competitive, increasing worker productivity should be an important part of their overall management strategy.

The unemployment rate is currently at 4.3%, the lowest rate since 1970 (Bureau of Labor Statistics, 1999). This means that good employees are harder to find and to keep. It is important that current employees are retained, developed, and motivated. Feedback can be one of the most effective motivational tools available to organizations (Moss and Martinko, 1998). Therefore, performance appraisals can be an effective tool in increasing productivity. Researchers have been studying ways to make performance appraisals more effective. Findings in recent years have shown that sources, frequency, and objectivity of the ratings can

all have an impact on the effectiveness of the performance appraisals. It is also important to use the performance appraisal as a developmental tool as well as a judgmental evaluation.

BACKGROUND

Rating Sources

An important issue facing management involved the decision regarding *who* should do the employee evaluation. Today, this responsibility still belongs primarily to the immediate supervisor. However, this reliance on the supervisor as the sole evaluator may not be a good idea (Bhote, 1994). Today, organizations are embracing alternative information inputs for employee evaluations. Two of these alternatives involve the use of outside evaluators or consultants and the gathering of information from multiple stakeholders.

Outside consultants. One of the reasons that appraisal systems are often ineffective is because managers dislike doing them, and therefore, they often avoid doing them unless forced. An alternative is to outsource this task to an outside consultant. There are pros and cons to this method as suggested in a study of Science Systems, Ltd. by Howell and Cameron (1996). On the positive side, this system takes up less management time, and employees are often more open regarding their future career plans with an outside consultant. Also, it is easier for a third party to give honest, straightforward feedback, because direct supervisors often feel that criticism may cause demotivation or unwanted turnover.

However, there is also suggest a downside. Bringing in an outside agent will put an added burden on what might already be a tight budget. There is also the fear that such a system might result in managers no longer discussing performance issues with their employees. Finally, Howell and Cameron questioned whether the employees would take third party feedback seriously.

Whatever the pros and cons, one advantage that is often apparent in using an outside agent in the employee appraisal process is that the agent usually seeks multiple sources of information on the employee's progress. The use of multiple information sources in becoming a growing trend in organizations whether or not an outside agent is employed.

Multi-source ratings. One of the newer trends being embraced by larger companies such as General Electric is the "360^0 evaluation." This procedure involves the participation of various stakeholders in the appraisal process. This can include supervisors, peers, direct-reports, customers, and the employee. Various studies have examined the efficacy of each type of evaluator and found mixed results (Roberts, 1995; Lathan and Wexley, 1994). For example, Kane and Lawler (1978) did a review of peer assessment literature and found that peer ratings tend to be reliable and accurate due to their access to unique information on the job performance. However, these co-workers often will not give honest appraisals, because they fear possible retaliation. Other researchers found that self-information is often inflated but can provide a good starting point in a feedback session (Bassett and Meyer, 1968).

The 360^0 evaluation has shown positive outcomes. A recent study (DeLeon and Ewen, 1997) found that the change from the use of supervisor evaluations to a process using multiple sources of information increased employees' perceptions of fairness. It also positively impacted the effectiveness of the appraisals. This was particularly true among protected classes such as females, non-whites, and the youngest and the oldest workers.

Frequency

Employers dislike doing performance appraisals and employees dread receiving them. For this reason many managers fail to evaluate the employee, even on a yearly basis (Laumeyer and Beebe, 1988). However, not only is feedback important for a smooth running operation, but also research has shown that employees believe that feedback on their performance is very important. One study (Ludeman, 1991) found that employees ranked performance evaluation as one of their top five priorities. Sixty-five percent of the employees studied believed that they did not get adequate feedback, and many of them believed that the feedback should be given more than once a year. However, the employees did indicate that they preferred that these interim evaluations be informal. This would eliminate unwanted surprises while taking the pressure off both the manager and the employee.

Quinton Stutter, President of Baptist Hospital, Inc., instituted a feedback system where supervisors and managers receive "report cards" every 90 days. As a result, in the past two years turnover has decreased significantly (Lyons, 1999).

Documentation

Documentation of employee behavior has been shown to be significant for a variety of reasons. First, it allows the manager to objectively evaluate the employee over the entire appraisal period. The manager has concrete examples to justify a given rating and to discuss areas of needed improvement. This objectivity allows the small business manager to focus on behavior rather that personality. This is important because focusing on objective results rather than on personal traits tends to protect a worker's self-esteem. An investigation on employee evaluations conducted by Renn and Prien (1995) found that a worker's self-esteem impacted an employee's job performance, general job satisfaction, absenteeism, and job search intentions.

Second, documentation protects the manager in cases filed with the Equal Employment Opportunity Commission (EEOC) by employees. The possibility of judicial and agency review of performance appraisals continues to expand in the United States (Carrell, Elbert, and Hatfield, 1995). Performance appraisals often become an integral part of a discrimination case, and thorough documentation helps to protect the employer. Small businesses with 15 or more part-time or full-time employees are subject to EEOC guidelines under the Civil Rights Act of 1964, American with Disabilities Act, and the Equal Pay Act. Employers with 20 workers or more are also subject to enforcement of the Age Discrimination in Employment Act. Lawsuits filed under these laws can be very costly and may even lead to bankruptcy (EEOC).

The advent of the personal computer has made this documentation much easier for the small business owner or manager. New information technology even allows the small business manager to keep records and do a 360^0 evaluation over the Internet (Bracken, Summers, and Fleenor, 1998).

Outcomes of Effective Performance Appraisals

There have been several studies regarding the outcomes of performance appraisals. For example, Pooyan and Eberhardt (1989) found that the supervisor's goal setting behavior and the supervisor's relations with the subordinate accounted for 53% of the variance in appraisal satisfaction. An examination of 113 empirical studies on performance appraisals published between 1980 and 1990 found that not only are multiple raters more effective than single raters, but that performance feedback is positively correlated with ratee job satisfaction

(Wanguri, 1995). Further, employees that were assessed in an objective goal setting system were significantly more satisfied than those evaluated under the more subjective trait approach.

Another meta-analysis of previous studies (Cawley, Keeping, and Levy, 1998) looked at the effects of employee participation in the appraisal process. They found that worker participation in the appraisal process was directly related to employees' satisfaction with, and acceptance of, the appraisal system. Also, participation was positively related to four outcomes: perceived fairness of the appraisal, perceived utility of the appraisal, motivation to improve after the appraisal, and positive employee reactions to others.

Small Business Appraisal Practices

Many practitioners make suggestions as to what small business owners should do in reference to performance appraisals. Svatko (1989) discussed the benefits of simplifying the performance appraisal, suggesting that this made the performance review process more acceptable to both managers and employees. He pointed out that at Paychex, a payroll processing firm, the performance evaluation was more effective when the bulk of the evaluation session was spent on objective goal setting. Alexander (1989) discussed the importance of using the performance appraisal to focus the employee's attention on long-term objectives rather than day-to-day output, and as protection from wrongful discharge lawsuits. Jacobs (1993) suggests that performance evaluations can be used to help employees improve both their performance and productivity, resulting in greater success for the firm. However, there has been very little empirical research done on how small business owners actually handle performance appraisals.

The purpose of this study is to present the results of an exploratory study performed in the South Florida small business community. It examines how small business owners/mangers actually apply the concepts discussed above. This study attempted to investigate how the evaluation of their employees is actually handled.

METHODOLOGY

Sample

A questionnaire was developed specifically for this study. The survey was mailed to a randomly selected sample of 200 small business owners in the South Florida area obtained from membership directories from local chambers of commerce. Of those surveyed, 98 (49%) responded. Eighty-eight (90%) of the respondents were men and ten (10%) were women. Whites accounted for 91 (92%) responses, while Blacks accounted for seven responses (8%). Eighty of the respondents had five or more employees, while eighteen had less than five employees. All of the respondents were small business owners.

Questionnaire

The questions centered on who performed the evaluation, how information on performance was gathered, which dimensions were used, and the evaluation outcomes. The respondents were asked to rate eleven dimensions chosen from an overview of the performance appraisal literature. These dimensions included: quality of work positive attitude, required skills, creativity, accountability, pleasant personality, quantity of work, good communication skills, dependability, cooperativeness, and regular attendance.

The efficacy of most of these dimensions was confirmed in a study on effective performance dimension carried out on 1,725 employees at ARCO Transportation Co., a division of Atlantic Richfield Co. (Rollins & Fruge, 1992). The present study also investigated some outcomes of the evaluation process.

FINDINGS

Information Gathering Systems

Many employees in small businesses never receive a formal evaluation. Their compensation and length of employment are at the whim of their employer. All of the organizations with less than five employees indicated that they did not do any performance evaluation, formal or informal. The remaining eighty were asked whether the performance of employees was evaluated formally or informally. Seventeen (21%) of the owners evaluated their employees formally, while sixty-three (79%) evaluated the employees informally.

The authors also sought to determine who in the organization actually did the evaluation. As shown in Table 1, most of the evaluations were done by the small business owners, approximately 12% were done by a manager that worked for the owner, and 10% were outsourced to an agency specializing in human resource functions.

Table 1: Who Does the Evaluation?		
Evaluator	*Number*	*Percentage*
Owner	62	77.5%
Manager	10	12.5%
Agency	8	10%

It was also of interest to investigate the frequency with which the appraisals were performed. Table 2 shows that for the owners that did employee evaluations, the majority of the evaluations were done once a year, but 36% were done more frequently.

Table 2: Frequency of Performance Appraisals		
Frequency	*Number*	*Percentage*
Yearly	51	63.8
Six Months	18	22.5
More Often	11	13.7

The authors wanted to know not just how often the evaluation was done with the employee, but also whether the accumulation of appraisal information was an ongoing process throughout the evaluation period. To investigate this question we asked the following, "Do you keep regular notes and documents on employees' performance?" 49 (61%) responded positively, while 31 (39%) responded negatively.

Source of information is often as important as the frequency. Most information for appraisals is gathered through direct contact and impressions from the immediate supervisor. The owner was asked where he or she gathered most of his or her information. Table 3 shows the three most prevalent sources of performance information. As can be seen from this table, the

majority of owners (60%) relied on their personal observations. However, 40% relied on other sources of information.

Table 3. The Major Source Of Employee Information

Source of Information	Number	Percentage
Observation	48	60%
Peers	11	13.7%
Employee	21	26.3%

Performance Dimensions

There are many different types of performance appraisal systems; i.e., graphic rating scales, alternation ranking, and paired comparisons, among others. For the purpose of this study it was decided that the type of evaluation was relatively unimportant for two reasons. First, graphic rating scales are the most commonly used system in performance appraisal. The majority of organizations use this type of evaluation. Due to the simplicity of this method this usually holds true for small businesses. Second, since many small business owners/managers have not had a course in human resource management, the authors believed that the jargon might be too confusing and too hard to explain. Therefore, rather than dwelling on the structure of the evaluations, the decision was made to investigate which *dimensions* small businesspersons believed were the most important when they did an evaluation. They were asked to use the following four point scale: 4 = most important, 3 = important, 2 = somewhat important, and 1 = not important. The results are presented in table 4.

Table 4: Perceived Importance of Rating Dimensions

	Importance of Dimensions*			
Dimensions	*Most Important*	*Important*	*Somewhat Important*	*Not Important*
Quality of Work	100%	0%	0%	0%
Positive Attitude	100	0	0	0
Required Skills	74	14	12	0
Creativity	85	11	4	0
Accountability	100	0	0	0
Pleasant Personality	94	5	1	0
Quantity of Work	95	2.5	2.5	0
Good Communication	100	0	0	0
Dependability	100	0	0	0
Cooperativeness	89	11	0	0
Regular Attendance	100	0	0	0

*Scores given by percentage giving each response.

As shown in table 4, all of the dimensions were fairly important parts of the evaluation process. It is interesting to note that the questions regarding actual work output, such as accountability, quantity and quality of work, dependability and attendance were of the utmost importance. While still taken into consideration, other dimensions such as creativity, personality, and cooperativeness were not quite as important. The most surprising results were that the level of skills received the lowest overall rating.

As expected, the owners rated all the dimensions as fairly important. To attempt to investigate relative importance, two questions were asked involving the interactions of the dimensions. This was done as an attempt to determine the importance of personality if the employee exhibited low productivity. Under this scenario, personality became less important dropping from a 94% rating on 4 (most important) on the rating scale, to 84% on most important. The second question asked respondents to rate the importance of attitude in the face of poor performance. Here the difference was most dramatic. As is evident in Table 4 when asked whether attitude is important as a free-standing measure, 100% of the respondents replied that attitude was very important. However, when asked to rate attitude in the face of poor performance no respondent said that attitude was important or very important (Table 5).

Table 5. Importance Of Interaction Of Performance Dimensions.

Interaction of Dimensions*				
	Most Important	*Important*	*Somewhat Important*	*Not Important*
Personality *if* Productivity Low	84	10	5	1
Attitude *if* Performance Poor	0	0	14	86

*Scores given by percentage response for each category.

Outcomes of Performance Evaluations

The importance of performance evaluations does not lie in the evaluation itself, but rather the outcome of that evaluation. For an employee to meet expectations it is very important that he or she be aware of the expectations of the owner/manager. To help determine this, the employers were asked whether employees have well-defined jobs on which they can be evaluated. Sixty-one (76.3%) believed that they did, and 19 (23.7%) said that they did not. The respondents were also asked whether they explained to their employees the basis on which the evaluations were made. Of those who replied, 71 (89%) said 'Yes' and 9 (11%) said 'No'.

Finally, the authors attempted to investigate the consequences of the performance appraisal. Respondents were asked, "When an employee receives a low rating, what action do you take?" None of the respondents replied that they would fire the employee. Forty-two (52%) indicated that the employee would be given one more chance, while 38 (47.5%) indicated that the employee would be encouraged, and the owner would discuss methods of performance improvement with the employee.

DISCUSSION

This study has given some insight into the use of the performance appraisal in the small business environment. The study found that most of the evaluations are done by the owner,

and that they evaluate the employees at least annually and sometimes more often. While there are not any hard guidelines on how often these evaluations should be conducted, Saal and Knight (1988) suggest that formal evaluations should be conducted at least every six months to prevent the cognitive overload of the raters. However, they also suggest that informal feedback should be given on a frequent basis.

The results on the importance of the rating dimensions have shown that the small business owners prescribe to a more present orientation than a future orientation. The responses showed that getting the job done was much more important than how it got done. Overall, productivity, dependability, attendance, and accountability were more important than creativity, personality and attitude. This is logical considering that many small businesses survive on a day to day basis, and with a very small workforce, dependability and attendance become crucial. However, if these organizations are to grow and prosper, creativity and cooperation become very important dimensions. It would be interesting to investigate whether a company's profitability, size, and maturity have an impact on the owner's perceived importance of the dimensions.

The finding that skill level is the least important dimension may be attributed to the fact that small business owners see it as a function of initial employee selection rather than employee evaluation. However, skill level should be an important part of continuing employee development, and therefore, should be considered an important dimension.

As mentioned in the introduction, this study is only a preliminary investigation. Many other questions need to be answered. Some of these questions may be related to demographics. It would be interesting to investigate the effects of the gender and the ethnic background of the rater and the ratee on the evaluation process in the small business environment.

Landy and Farr (1983) looked at the uses of resultant evaluation information, and suggested that three uses should be made of the information. First, the information should be used to make administrative decisions regarding compensation, promotions, and dismissals. Second, it should help in employee development by providing feedback on an employee's strengths and weaknesses. Third, it will provide support information that might be useful in strategic planning and compliance with EEOC regulations. It would be interesting to discover what the small business owner is actually doing with the information that he or she is gathering in the performance appraisal process.
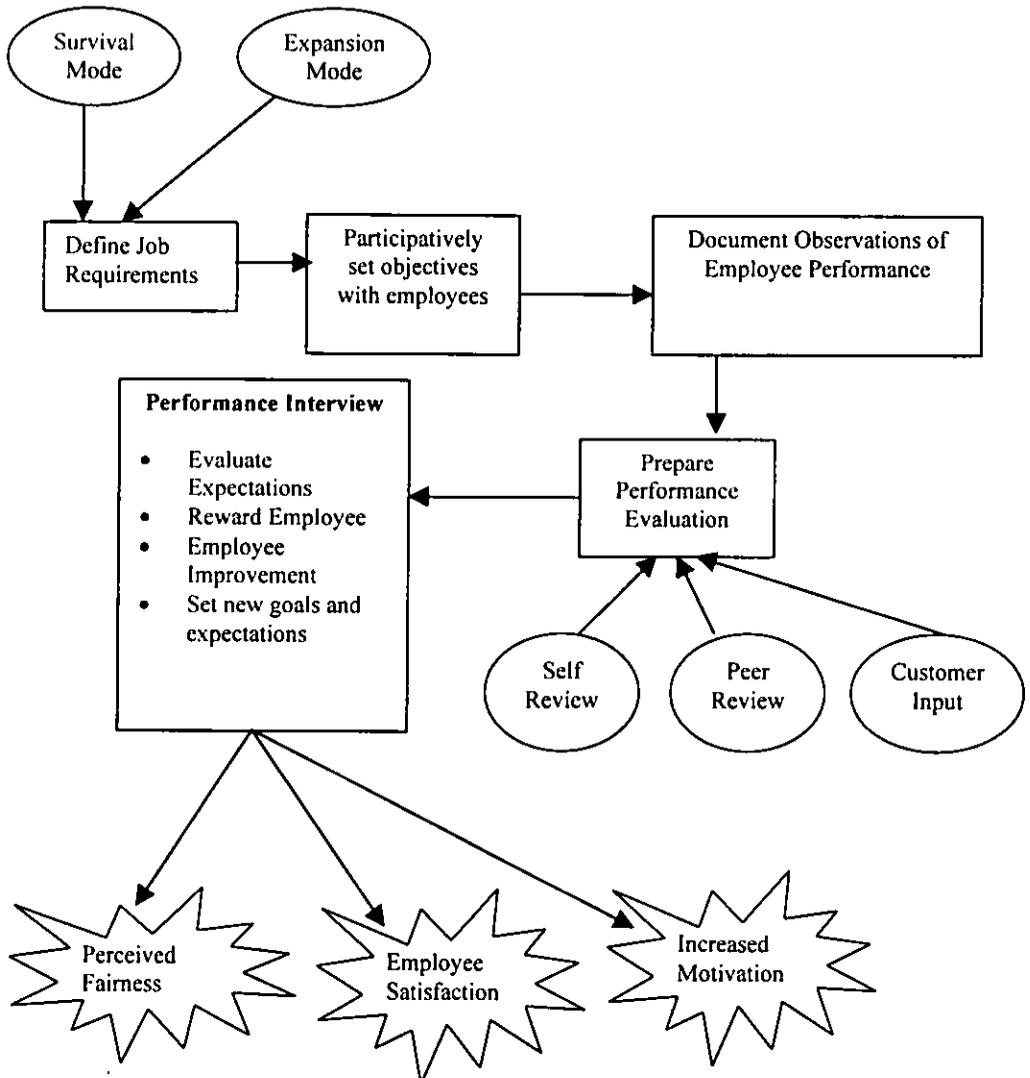
Finally, our study showed that 10% of those responding to the survey outsourced the performance appraisal function. Outsourcing is a growing trend in the area of human resource management (Stewart, 1996). Therefore, it would be interesting to study the small businesses that are currently using outside agencies to perform their human resource functions and to analyze how this relates to the cost effectiveness and usefulness.

GUIDELINES FOR EFFECTIVE USE OF PERFORMANCE EVALUATIONS

A review of the results of our survey suggest that although most small business managers grasp the importance of doing performance appraisals, many do not realize the importance of them as a developmental tool that can be used to increase employee productivity. The process shown in Figure 1 can be adapted by small business managers to make the performance appraisal process more effective and efficient. This can help to increase the employee's satisfaction and perceptions of fairness, and also help to protect the small business from legal repercussions based on poor evaluation practices.

The first step is for the owner (manager) to define the job requirements for each employee. The question must be asked, "What is this employee supposed to do?" The time frame for this job analysis depends on whether the company is in a survival mode or in an expansion mode. If the company is concentrating on staying afloat (survival mode), the job analysis should concentrate on the employee's job today. In this mode, the manager should write all of the tasks that the employee is expected to perform, and attach objective levels of performance to the tasks whenever possible. For example, rather than saying "make sales calls", the description should say, "make 10 sales calls a day, making a sales on at least 50% of the calls, selling a minimum of 1,000 widgets a week."

Figure 1. GUIDELINES FOR AN AFFECTIVE PERFORMANCE APPRAISAL PROCESS

If the company is in a growth phase (expansion mode), the job analysis should not only focus on today, but also two to five years into the future. For example, take a business which is currently doing all of its sales by telephone or in-person. However, within the next two years the company plans to begin selling its products over the Internet. To write a job description for a clerical worker who would be doing the company's computer work, you could write the job description to include "works with word processing, spreadsheets, database inputs, and web page updates."

The second step begins the development phase. The owner/manager meets with the employee to not only setup goals, but also to discuss how they are to be achieved, what the supervisor can do to assist the employee, and possible roadblocks the employee may face. For example, the owner would not just tell the salesperson how many units he/she is expected to sell, but he/she might also suggest effective selling techniques, and good times to contact prospects. The owner should accompany the salesperson on some sales calls and give feedback. When a prospective customer who will not return phone calls becomes a roadblock, the owner/manager may suggest other approaches to contacting the customer such as approaching someone else within that company or using e-mail.

Time frames must be setup so that the manager can evaluate the progress and give the employee feedback on interim performance. This can be done informally, but at specific checkpoints. An owner/manager may set up a six-month goal of selling 6,000 widgets. However, he could say to the employee, "Let's meet in a month and check your progress. By that time, you should have sold at least 1,000 widgets using the techniques that we discussed." It is very important that the owner/manager does check the accomplishment of the goals at the end of the specified time, otherwise the employee will not take the goals seriously. Also, interim feedback sessions should aid in this process by reducing anxiety levels in the employee. If the employee is doing well and has sold 1,000 widgets by the end of the month, positive feedback can be very motivational. However, if the employee is not doing as well as expected, this is the best time to straighten out the problem with specific suggestions. It is important that the owner/manager inspects what he/she expects. This is important because it ensures that the manager and the employee are on the same wavelength; that is, the are striving for the same goals. It will minimize the possibilities of misinterpretations on the part of the employee of what he/she needs to accomplish to receive a positive evaluation.

Throughout the entire process the supervisor should be objectively documenting the employee's progress while coaching him/her to help meet the desired expectations. This documentation can take several forms. Some managers periodically write informal observations and keep them in the employee's file. It is best to use a more formal process. This will be especially helpful when faced with lawsuits regarding employment. A simple, yet efficient process is to use a weekly log for each employee. In this log, the owner/manager notes observations of the employee's work related behavior over the past week. The information should focus on the work, not the personality of the worker. The comments should be objective and specific. Therefore, rather than stating that the worker was lazy, the manager might record, "On Thursday, July 12, Mr. Smith had to be asked three times to shelve the product that had been delivered that day." Rather than noting, "John is always late," the owner/manager should write, "On June 6, John was 30 minutes late, on June 8, John was 20 minutes late, and on June 9, John was 40 minutes late." It would also be wise to note the corrective actions taken as well as the time period given to improve behavior.

Before preparing the formal evaluation, the supervisor should carefully examine all documentation on performance, review all interim evaluation sessions, and solicit input from other sources (peers, customers, etc.) The supervisor should mentally review what he/she wants to convey, so as to assess the possible reaction of the employee. By preparing several

scenarios, one for each possible reaction, the owner/manager is not caught off guard, and therefore, will remain in control of the situation.

Finally, the manager should meet with the employee to evaluate whether the expectations originally set forth were met. If interim feedback sessions were conducted prior to the formal evaluation, the appraisal should not be a surprise to the employee. The more important part of this session is to discuss with the employee where the owner/manager wants him/her to go from here and to set a course of action for the employee to follow. This course of action and the new goals that are participatively established will become the basis for the next performance appraisal.

CONCLUSION

This paper explores an area that is crucial to the effective management of one of our most important resources, people. As an exploratory study, it raises many questions regarding the current human resources practices in small businesses, and the lack of the effective use of performance appraisals. It is not surprising that eighty-two percent of the companies studied realize that some type of performance evaluation is necessary; however, it was surprising to find that that only seventeen percent of the total sample had a formal appraisal process. More research needs to be done to determine if these findings hold true in different industries and whether they are consistent across various geographic regions.

Nevertheless, the findings do seem to indicate that while small business owners/managers realize that they should do some kind of employee evaluation, they do not understand the strategic importance of implementing an effective employee appraisal process. A formal employee evaluation process, as suggested in this paper, will take time out of a manager's already busy day, but such a commitment is well worth the effort. The results could include higher worker productivity, legal protection, and more satisfied employees.

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