Performance evaluations:
Subjectivity + traditional measures

Despite the benefits, managers need to use subjectivity with caution.

By **Suzanne Landry**, FCMA, and **Eduardo Schiehll**, CMA

ONE OF THE MAIN CHALLENGES OF designing an incentive compensation system is choosing the criteria for evaluating and rewarding performance. The metrics have to be informative and timely, and must take into account how today's actions will affect tomorrow's performance. And it all has to be done without transferring too much risk to the manager.

Traditional financial outcome-based measures rarely fit the bill. Although they're objective and verifiable, they tend to be too backward-looking. They can reward unwanted behaviour and don't emphasize intangibles such as intellectual capital or managerial skills. In addition, bonuses are increasingly linked to broader business goals such as quality, customer service, reputation, and hiring and retention policies.

For these reasons, there's now a trend to combine qualitative, subjective measures with traditional outcome- and profit-based measures. The result is a greater reliance on the supervisor's judgment — in other words, subjectivity.

Subjectivity allows supervisors to offset uncontrollable factors that can adversely affect managerial performance and to adjust performance ratings when they uncover performance manipulations. In short, subjectivity can improve incentive compensation by reducing risk for managers and incentive costs for the organization.

Subjectivity survey

We surveyed 339 CMA members from the Quebec CMA Order in mid- and upper-level management. The survey's results revealed that multiple performance measures, including subjective criteria, are widely used for evaluating and rewarding managerial performance. The average number of performance measures within the three metric categories — financial, non-financial and subjective — is 11.2. On average, a performance evaluation system is based 19 per cent on financial measures, 37 per cent on non-financial measures and 44 per cent on subjective measures.

Each performance measure category was also weighted, with a mean of 29 per cent for the financial, 38 per cent for the non-financial and 32 per cent for the subjective category. This confirms that the use of multiple performance dimensions are used and that financial and non-financial measures are systematically combined with a good dose of subjectivity.

Most importantly, the study revealed that this balanced approach is consistent across the 11 industry sectors surveyed. Subjective criteria even accounted for 42 per cent and 44 per cent in traditional sectors such as manufacturing and consumer business.

The study also revealed less emphasis on financial measures in public sector firms. One explanation is that measuring financial performance in the

public sector is more difficult than in the private sector. Many government programs are not profit-oriented and have multiple and changing objectives, justifying less use of financial measures to evaluate and reward managerial performance.

Determining bonuses

About 61 per cent of managers indicated that more than 50 per cent of their cash bonus was based on a supervisor's use of a subjective approach. Unlike a formula-based approach which uses objective and quantifiable (financial and non-financial) measures with predetermined weights, a subjective approach entails a supervisor's judgment based on an assessment of potential performance indicators, some of which may not be easily quantified.

The survey also revealed the use of two other forms of subjectivity. About 30 per cent of managers reported that the performance dimensions were weighted flexibly. Supervisors either did not predetermine the weights for the performance criteria or did use their discretion in weighing them after the evaluation period. They adjusted for uncontrollable factors and made incentives more representative of managerial efforts.

Supervisors also used subjectivity to define and allocate the amount of a bonus award. Twenty-seven per cent of managers surveyed said that their supervisors had full discretion in determining the total amount of a cash bonus, and about 33 per cent said that their supervisors could adjust the bonus award by considering factors other than predetermined measures and weights. This approach keeps managers motivated when pre-set performance targets become unreasonable or difficult to achieve, and allows supervisors to adjust compensation to better reflect collective and individual efforts.

The survey found that subjective measures are widely used together with outcome-based financial and non-financial measures. Two other forms of subjectivity can be incorporated: flexibility in weighting multiple performance measures and a supervisor's discretion in determining the bonus amount and allocation. Often used in combination, these three forms of subjectivity can improve the performance evaluation by filtering out uncontrollable events, offsetting problems with inadequate objective measures and neutralizing the effects of outside influences on performance. In the case of bonus payouts, subjectivity can also lessen the drawbacks of tying bonuses to outcome-based performance measures.

But the survey also revealed some downsides. Surveyed managers perceive that subjectivity may introduce bias in rating and ranking their performance. Subjectivity is meant to build incentives, but if performance outcomes cannot be properly verified, the assessment can become problematic and even discouraging for managers who may view the system as uncontrollable and unfair.

More specifically, cognitive limitations in the processing of performance information and the inability to verify performance outcomes can create assessment problems that limit the incentive-strengthening role of subjectivity in performance evaluation. Ultimately, despite the benefits, subjectivity needs to be used with caution. ▣

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DIVERSITY OF PERFORMANCE MEASURES

All industry sectors	All performance measures	Financial performance measures	Non-financial performance measures	Subjective performance measures
Average number	11.2	1.8	4.5	4.9
Average weight attributed to performance measure category		29%	38%	32%
Industry sectors	Number of firms (339)	% Financial	% Non-financial	% Subjective
		Mean	Mean	Mean
Public sector	64	9.8	43.1	47.2
Resources	30	24.0	33.5	42.5
Manufacturing	112	22.5	35.5	42.0
High-tech/biotech	35	17.2	34.7	48.2
Banking	50	20.6	40.1	39.4
Consulting	17	16.4	43.7	39.8
Health care/pharmaceutical	10	24.9	20.0	55.1
Consumer business	16	20.4	35.7	43.9
Missing information	5	—	—	—
Number of performance measures per category as % of all measures		19.1	37.2	43.7

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