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Performance evaluations and control system design

By **Stephan Kramer**

The accuracy of information available to managers about an employee's performance, combined with the transparency of performance evaluations based on that information, can help to motivate managers to reward good performance and highlight poor performance.

The issue has a particular relevance to the subject of performance evaluation within an organisation, whether that organisation is commercial, academic, public sector and even not-for-profit. Most people's experience of the ordeal that is an annual performance assessment, however, will likely be in the commercial world.

In a commercial situation, an individual's performance in achieving or failing to achieve certain targets such as sales, profitability, customer satisfaction, customer retention and staff satisfaction against a clear set of metrics is arguably relatively easily measurable. In many cases, the numbers will tell their own story, but nevertheless managers often need to subjectively determine an overall employee rating based on these objective performance measures.

One complicating feature in the determination of this rating is the role that the personal costs to a manager play in delivering, or not delivering, an accurate performance rating. From the employing organisation's perspective, a fair and accurate rating is undoubtedly good in terms of motivating employees to work hard in the year ahead. The problem is that, as our research demonstrates, it might not be in a manager's interest to provide a rating that can be truly regarded as accurate.

How can this be so? It is a recurring quirk of human nature that in most fields of activity people think of themselves as above average. In everyday working life very few will readily accept that they have performed poorly. If only to preserve their own inflated ego, people labelled as poor performers will tend to attribute underperformance to external circumstances, over which, of course, they have had little or no control.

A fine recent example of this phenomenon can be found in the many reactions to the UK electorate's vote to leave the European Union. So-called Brexit has been seized upon as an excuse for a broad spectrum of underperformance, from the dramatic slide in the pound sterling in the immediate aftermath of the vote to a series of stutters in the UK's domestic housing market.

Awkward scenarios

Returning to our research, we found that if a manager identified an employee as a poor performer, perhaps even a terrible performer, then the delivery of an accurate rating would reflect upon the manager's own poor performance and rating. Moreover, there would likely be other consequences, such as confrontation with a disgruntled employee, possibly resulting in an awkward appeal to a third party against the rating. Even if the manager is subsequently found to have awarded an appropriate rating, a formal investigation will have generated costs in terms of time, effort and emotion. In short, the manager will have experienced unwanted distraction, inconvenience and anxiety.

In a live work environment, what might the consequences be? We found that managers faced with such a potentially awkward scenario could be tempted to compress performance ratings; that is, reduce the spread between the poor ratings and the good ones.

While very good performers will continue to be designated as very good, and good deemed to be good, poor performers could be labelled as average. This is a bad thing, as the resultant artificial inflation of performance ratings does no one any good. The employee concerned will inevitably have a false sense of worth and therefore will see no reason to make

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an effort to improve performance; the employing organisation will equally inevitably suffer as a result of what is in effect a dishonest assessment.

Control system elements

What can an organisation do to address this problem? We suggest two specific control system elements that can combine to affect performance evaluations. The first is the accuracy of information about an employee's efforts. The second is organisational transparency about performance evaluation outcomes such as the ratings awarded and rewards promised.

When performance information is not accurate, supervising managers cannot be certain that poor performance manifested in the objective performance measures is in fact due to poor performance of the employee. For instance, if the customer flow in a region is highly volatile, then there may be times in which revenues come in low even though the employee worked hard to achieve a good result.

In such a situation, the supervising manager will likely give the employee the benefit of the doubt, leading to an inflated rating relative to what the performance indicators would warrant. When performance information is very accurate, the performance indicators tell a clear story whether the employee worked hard or not and there is no need to "err on the safe side".

However, when there is no transparency about employee evaluations and rewards, rating decisions are not fundamentally changed by an increase in the accuracy of information. In other words, as long as employees cannot observe each other's ratings and rewards, managers can still avoid certain personal discomfort by providing all employees with evaluation outcomes that do not necessarily tell the truth.

When employees can observe each other's ratings and performance, their satisfaction with evaluations will also depend on how their own ratings and rewards compare to those of their peers. Stronger performers will likely be disgruntled and demotivated when ratings are compressed because under a transparent system it is clear that their performance is relatively undervalued.

Because it is more important to keep stronger performers satisfied than weaker performers satisfied, managers will tend to differentiate ratings as a result, ie, the difference between ratings and rewards assigned to the stronger performer and the weaker performer is significantly larger when both information accuracy and outcome transparency are relatively high.

In conclusion, being accurate, open and honest will help to deliver an outcome that more closely resembles an accurate rating. Rather than relying on inaccurate information and opacity, this promotes the organisational development of human capital and drives long-term performance. ■

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