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EMPLOYER MORAL HAZARD IN PERFORMANCE EVALUATIONS: THE EFFECTS OF PERFORMANCE MEASURE SUBJECTIVITY AND JUSTIFICATION ON EMPLOYER OPPORTUNISM

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ABSTRACT

The increasing complexity of organizational performance management has intensified concerns about employer moral hazard in employee evaluation and compensation decisions. Although subjective performance measures allow managers to assess qualitative contributions that cannot be captured through objective indicators, managerial discretion may also create opportunities for opportunistic behavior. This study examines how performance measure subjectivity and justification requirements influence employer opportunism, perceived accountability, and compensation fairness. A qualitative narrative review of international academic literature was conducted, focusing on agency theory, performance measurement systems, managerial decision-making, and accountability mechanisms. The reviewed evidence indicates that subjective evaluations may increase the risk of biased compensation decisions when managers have personal financial incentives and limited accountability. However, requiring managers to justify their evaluation decisions can reduce certain forms of bias by encouraging greater attention to supporting evidence. The effectiveness of justification depends on organizational incentives, the audience receiving the explanation, and the potential for motivated reasoning. The study concludes that combining objective performance indicators, structured subjective assessments, and transparent justification procedures provides a promising framework for improving fairness and reducing employer moral hazard.

Keywords: employer moral hazard, subjective performance evaluation, employer opportunism, managerial discretion, accountability, justification, compensation fairness, performance management.

INTRODUCTION

Performance evaluation represents an essential element of contemporary human resource management and organizational control systems. Organizations use performance assessments to determine compensation, allocate rewards, identify professional development needs, and make promotion decisions. The effectiveness of these processes depends substantially on the reliability and fairness of performance measurement methods.Traditional performance evaluation systems frequently emphasize objective indicators, including productivity, sales volume, financial outcomes, and achievement of predetermined targets. However, objective measures may fail to capture important dimensions of employee performance, such as cooperation, creativity, leadership, adaptability, and organizational citizenship behavior.Baker, Gibbons, and Murphy (1994) demonstrated that subjective performance measures may complement objective indicators in incentive contracts, particularly when measurable outcomes do not adequately reflect employee contributions (1).

Despite these advantages, subjective evaluations introduce managerial discretion, which can increase the possibility of inconsistent or opportunistic decisions. Managers may manipulate evaluations, alter the relative importance of performance indicators, or distribute compensation according to personal preferences rather than actual employee contributions.Employer moral hazard occurs when an employer or managerial representative exploits informational advantages or discretionary authority to pursue personal benefits at the expense of employees or organizational objectives.Previous experimental research has demonstrated that the structure of employer discretion can significantly influence compensation allocation and employee behavior (2).Ittner, Larcker, and Meyer (2003) further established that subjective weighting of performance measures may allow supervisors to modify evaluation criteria and place excessive emphasis on selected indicators (3).These

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findings demonstrate the importance of identifying organizational mechanisms capable of reducing employer opportunism without eliminating the informational advantages associated with subjective performance measures.One potential solution involves justification requirements. When managers must explain their performance evaluation decisions, they may become more accountable and more attentive to the evidence supporting compensation decisions.

The objective of this study is to analyze the relationship between performance measure subjectivity, justification requirements, and employer moral hazard and to identify organizational mechanisms that may improve the fairness and transparency of employee performance evaluations.

MATERIALS AND METHODS

The research employed a qualitative narrative literature review supported by comparative analysis of established theoretical and empirical studies.The literature base comprised eleven academic works published between 1994 and 2025, including ten peer-reviewed journal articles and one doctoral dissertation. Sources were identified through academic publisher records, scholarly repositories, and DOI-indexed publications.

The selected studies addressed four principal research dimensions:

1. The relationship between objective and subjective performance measurements.
2. The influence of employer incentives and managerial discretion on compensation decisions.
3. The role of accountability and justification requirements in reducing evaluation bias.
4. The organizational consequences of perceived fairness and managerial opportunism.

The theoretical framework was based primarily on agency theory and behavioral approaches to performance evaluation.

Agency theory explains employer moral hazard through conflicting interests and information asymmetry between organizational participants. Behavioral approaches additionally consider fairness perceptions, cognitive biases, personal preferences, and the psychological consequences of accountability.

A comparative thematic analysis was used to identify recurring mechanisms, contrasting findings, and implications for performance management design.

The principal analytical relationships were expressed conceptually as follows:

Employer opportunism = f(Managerial discretion, Financial incentives, Information asymmetry, Accountability).

This expression represents a conceptual relationship rather than an estimated econometric model.

The study did not involve original employee surveys, experimental participants, or statistical hypothesis testing. Consequently, the results summarize evidence reported in the reviewed literature and do not represent independently collected empirical observations.

RESULTS

The comparative analysis revealed several important relationships between performance evaluation subjectivity, managerial discretion, and employer opportunism.

Subjective evaluation methods allow managers to incorporate qualitative information that is difficult to measure through standardized quantitative indicators.However, subjectivity also increases the importance of managerial judgment and may create opportunities for performance rating manipulation.Moers (2005) found that the use of multiple and subjective performance measures was associated with more compressed and lenient performance evaluations, potentially reducing the ability of appraisal systems to distinguish differences in employee performance (4).

These findings suggest that subjective evaluation is not inherently opportunistic, but its effectiveness depends on institutional safeguards and managerial incentives.

Financial incentives may influence the relationship between subjective evaluations and compensation decisions.Where managers benefit financially from reducing employee compensation, they may face incentives to award lower bonuses than employee contributions would otherwise justify.Fisher et al. (2005) demonstrated that different forms of employer discretion over compensation

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decisions generate different behavioral and organizational outcomes (2).Miller (2024) investigated employer moral hazard through a multi-period experimental design involving performance measure subjectivity and justification requirements. The primary hypothesis tests did not identify statistically significant main effects of either manipulation on employee bonus compensation.However, additional analyses indicated that, under employer budget-based financial incentives, predominantly subjective performance measures were associated with lower employee bonuses through reduced perceived accountability. Additional findings suggested that justification requirements could mitigate this pattern (8).

Therefore, the influence of subjectivity on employer opportunism should be interpreted as conditional rather than universal.

An important finding concerns the potential effectiveness of justification requirements as organizational control mechanisms.Lang (2019) demonstrated theoretically that requiring explanations for subjective assessments can constrain opportunities to distort evaluations and can improve the credibility of compensation decisions (6).Maske, Sohn, and Hirsch (2021) provided experimental evidence that managerial accountability, introduced through a requirement to justify bonus decisions, reduced a halo-related bias in discretionary bonus adjustments (7).Nevertheless, justification does not eliminate every form of performance evaluation bias. Recent evidence indicates that managers may engage in motivated reasoning when processing unfavorable information concerning preferred employees, thereby limiting the effectiveness of accountability mechanisms (9).

Transparent evaluation procedures influence employee perceptions of organizational fairness.Bellavance, Landry, and Schiehll (2013) showed that certain forms of ex-post managerial discretion in weighting performance measures can adversely affect perceptions of procedural justice (5).Furthermore, subjective evaluation systems may encourage employees to redirect their efforts toward satisfying evaluators rather than maximizing organizational performance.Evidence from a randomized field experiment among Chinese civil servants demonstrated that subjective appraisal arrangements can generate evaluator-specific influence activities (10).These findings emphasize that performance evaluation systems should be assessed not only by their immediate compensation consequences but also by their effects on employee behavior and organizational efficiency.

Table 1. Summary of the principal findings from the reviewed literature

Evaluation factor	Main benefit or potential risk	Relevant evidence
Objective performance measures	Verifiable indicators, but incomplete coverage of employee contributions	Baker et al. (1)
Subjective performance measures	Improved qualitative assessment, but greater exposure to rating bias	Ittner et al. (3); Moers (4)
Managerial financial incentives	Potential conflict between employer compensation and employee rewards	Fisher et al. (2); Miller (8)
Justification requirements	Potential reduction in opportunism and certain evaluation biases	Lang (6); Maske et al. (7)
Managerial accountability	Greater scrutiny, although motivated reasoning can limit effectiveness	Bauch and Weißenberger (9)
Procedural transparency	Greater potential for perceived fairness and credible evaluation practices	Bellavance et al. (5)

Source: Author's synthesis of the cited literature.

DISCUSSION

The findings indicate that employer moral hazard represents a multidimensional problem involving economic incentives, information asymmetry, organizational structures, and managerial behavior.Subjective performance evaluations create an important managerial trade-off. While increased discretion enables organizations to recognize qualitative employee contributions, it simultaneously

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creates opportunities for inconsistent or self-interested decisions.The results of previous studies support the argument that employer opportunism cannot be explained exclusively by the presence of subjective measurement. Rather, opportunistic behavior becomes more plausible when managerial discretion is combined with financial conflicts of interest and limited accountability.The evidence also suggests that justification requirements may operate through both informational and psychological mechanisms.From an informational perspective, managers required to explain their decisions may need to identify credible performance evidence and demonstrate consistency between assessment criteria and compensation outcomes.

From a psychological perspective, anticipated accountability may increase the perceived consequences of biased decisions and encourage more careful evaluation.Nevertheless, accountability procedures can be ineffective when explanations become merely formal exercises or when managers selectively interpret performance information.The findings of Bauch and Weißenberger (2025) are particularly relevant because they demonstrate that increasing cognitive processing effort does not necessarily eliminate favoritism when motivated reasoning remains present (9).

Therefore, justification should be considered one component of a broader performance management system rather than a universally effective independent solution.

An effective organizational framework may incorporate predetermined performance criteria, clearly defined subjective assessment scales, written explanations of discretionary adjustments, independent reviews of exceptional compensation decisions, and accessible employee appeal procedures.Furthermore, compensation structures should be designed to minimize situations in which supervisors receive direct personal benefits from reducing legitimate employee rewards.These recommendations are derived from the collective implications of the reviewed literature and require additional empirical validation across organizational and cultural contexts.Future research should investigate the effectiveness of justification requirements in different economic sectors and examine how digital performance management systems, algorithmic decision support, and organizational transparency influence employer moral hazard.

CONCLUSION

The study demonstrates that performance measure subjectivity and justification requirements are important factors in understanding employer moral hazard.Subjective performance assessments provide valuable opportunities to evaluate employee contributions that cannot be represented adequately by quantitative indicators. However, managerial discretion may also facilitate opportunistic compensation decisions when financial incentives and information asymmetry are insufficiently controlled.The reviewed research suggests that justification requirements can reduce selected evaluation biases and strengthen perceived accountability. Nevertheless, these effects are conditional and may be weakened by favoritism, motivated reasoning, and poorly designed incentive structures.A balanced performance evaluation system integrating objective indicators, structured subjective judgments, transparent explanations, and independent oversight may provide a more reliable foundation for fair compensation decisions.

The central conclusion is that reducing employer moral hazard requires not the elimination of subjective evaluation, but the establishment of institutional safeguards that make managerial discretion transparent, accountable, and consistent with legitimate employee performance.

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