

## 2. Evaluating Financial Performance

# Compagnie du Froid: Agenda (b)

1. Additional Challenges
2. Transfer Price Fundamentals (only if time allows)
3. Transfer Price & Effects
4. France & Spain
5. Typical Recommendations
6. Overall Conclusions
7. Summary

# Compagnie du Froid: Agenda (b)

## 1. Additional Challenges

# More Questions

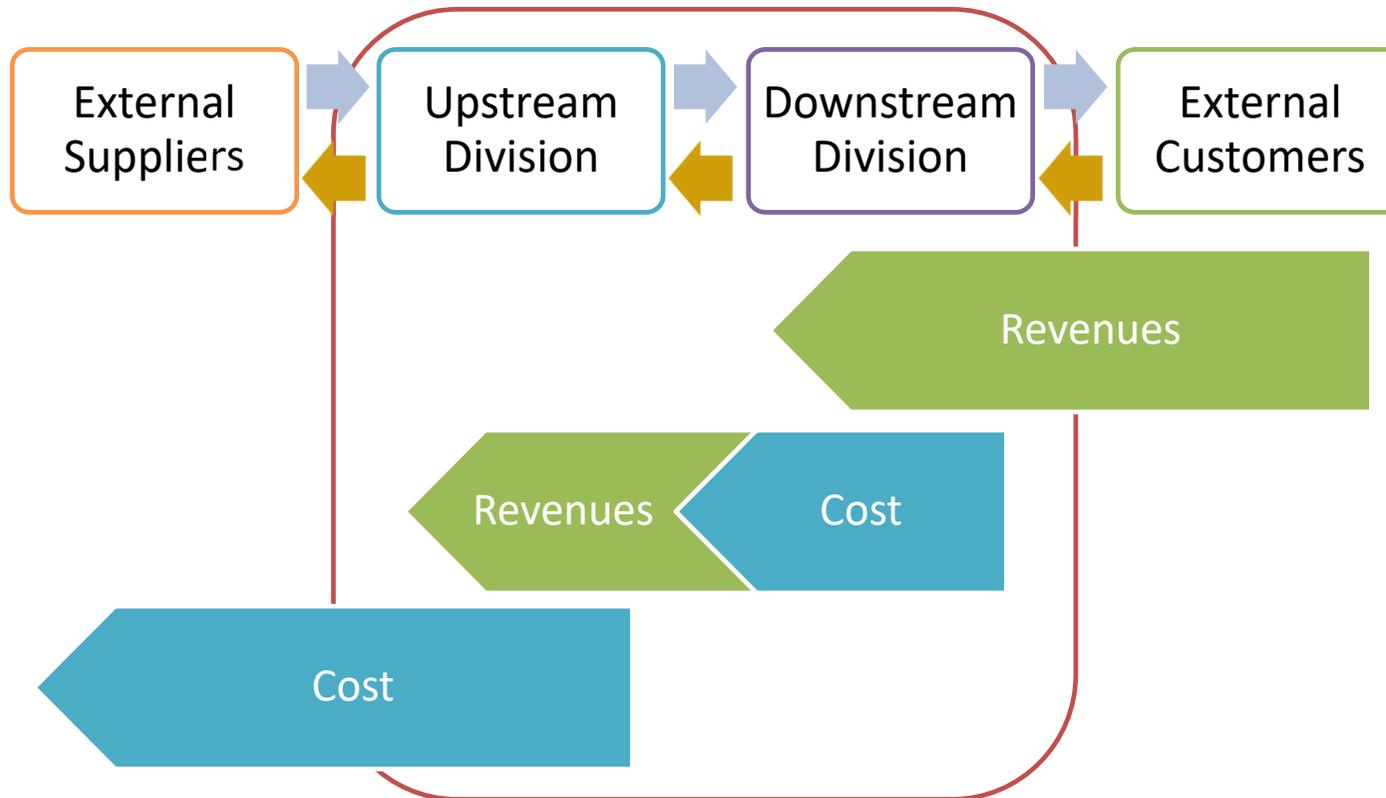
- “Disruptions”:
  - Transfer price France – Spain?
  - Diversification France?
- **Decision & action-orientation:**
  - What do we make out of the insights from the variance analysis?
  - What do we do with respect to:
    - Diversification?
    - Transfer price policy?
    - Bonus scheme?
    - ... anything else important?

# Compagnie du Froid: Agenda (b)

1. Additional Challenges
2. Transfer Price Fundamentals (only if time allows)

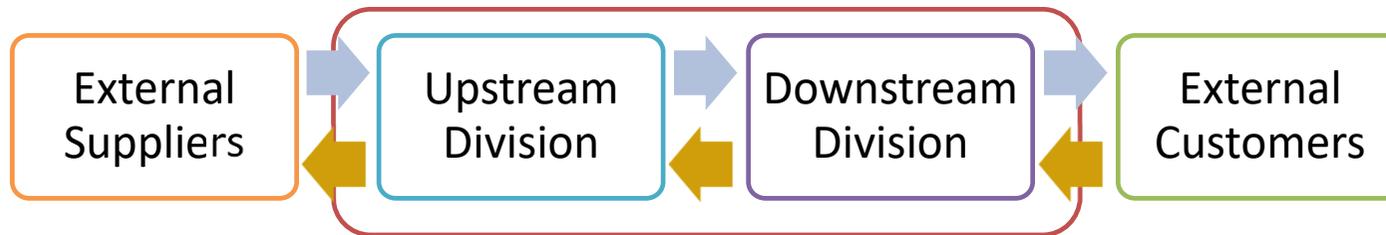
# Transfer Price

- Measures the profit consequences of internal trade:



# Transfer Price

- Measures the profit consequences of **internal trade**:



- Sharing-rule** of value creation:
  - Upstream (internal supplier): deserves (at least) reimbursement of incurred costs (alternative: sell externally).
  - Downstream (internal customer): should pay for received services & products (alternative: source externally).
- Profit shifting**: from one profit center of the company to another.

# Transfer Price: Objective #1

- **Tax & tariff management** (not covered in this course):
  - Taxes: minimize taxable profit (= income tax) in high tax country, maximize taxable profit in low tax country.
  - Tariffs: minimize flow of physical goods with high import and/or export tariffs.

# Transfer Price: Objective #1

Deloitte.

2016 Global Transfer Pricing  
Country Guide



## Contents

3	Foreword	147	Kazakhstan
4	Angola	152	Kenya
8	Argentina	155	Korea
12	Australia	159	Latvia
20	Austria	162	Lithuania
24	Belarus	166	Luxembourg
27	Belgium	169	Malaysia
31	Brazil	173	Mexico
35	Bulgaria	177	Netherlands
39	Canada	181	New Zealand
43	Chile	185	Norway
47	China	189	OECD
53	Colombia	193	Peru
57	Costa Rica	197	Philippines
61	Croatia	200	Poland
65	Czech Republic	205	Portugal
68	Denmark	209	Romania
72	Dominican Republic	214	Russia
75	Ecuador	218	Saudia Arabia
79	Egypt	221	Singapore
84	El Salvador	225	Slovakia
87	Estonia	228	Slovenia
91	Finland	232	South Africa
95	France	237	Spain
99	Germany	242	Sweden
103	Greece	245	Switzerland
108	Guatemala	249	Taiwan
112	Hong Kong	253	Thailand
115	Hungary	256	Turkey
119	Iceland	260	Ukraine
123	India	263	United Kingdom
127	Indonesia	268	United States
132	Ireland	271	Uruguay
135	Irael	274	Venezuela
138	Italy	277	Vietnam
143	Japan	282	Contacts

- Up to date information:  
[https://dits.deloitte.com/  
#TransferPricingGuides](https://dits.deloitte.com/#TransferPricingGuides)

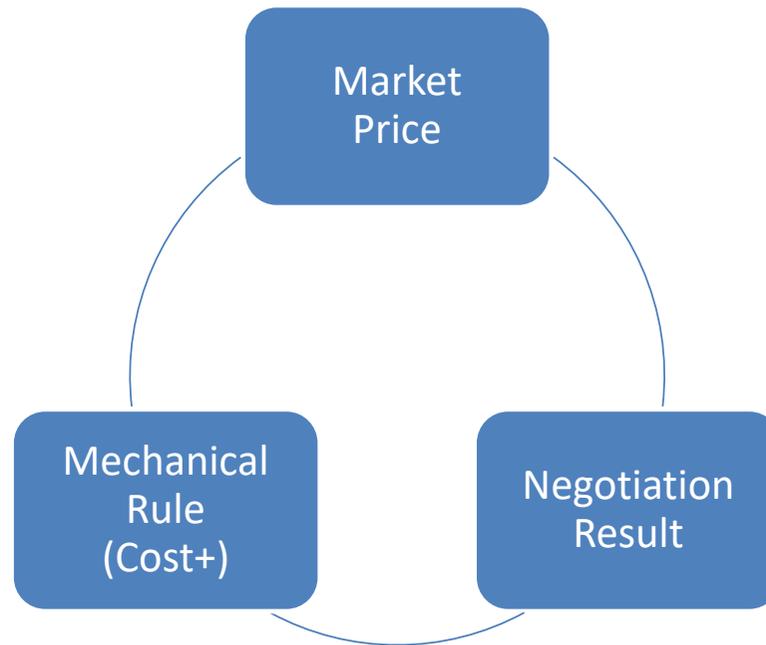
## Transfer Price: Objective #2

- **Organizational performance management & value creation** (even without differences in taxes and/or tariffs).
- **Numbers:** divisional profit measurement.
  - Decision-making.
  - Performance evaluation.
  - Financial reporting (segment disclosure).
  - Tax & tariff optimization.
- **People:** incentive effects towards goal congruity.
  - Delegation: central vs. de-central decisions.
  - Effort: decision-making in best interest of division.
  - Information sharing: price “reveals” information.
  - Coordination: decision-making in best interest of firm.

Problem of  
direct conflict:  
internal supplier  
↔  
internal customer.

# Challenges/Solutions?

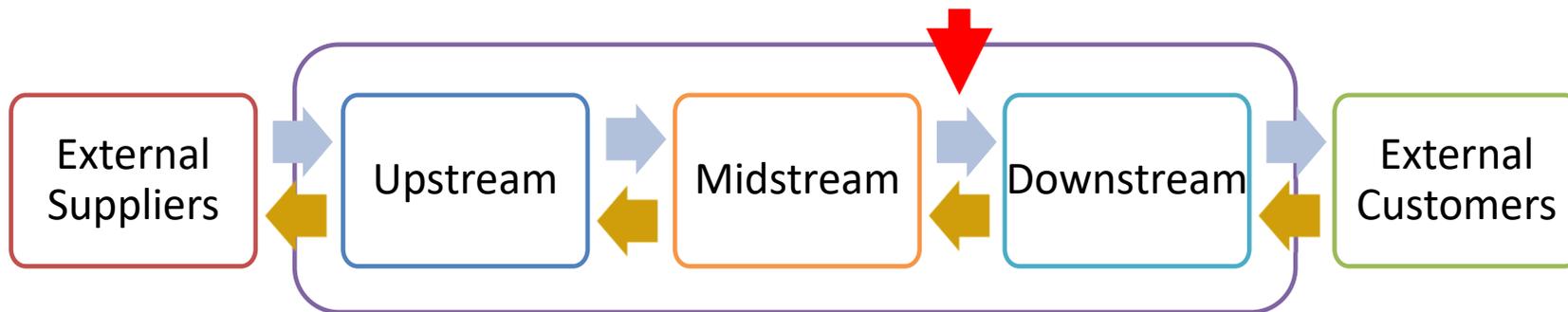
# Common Transfer Price Approaches



# Transfer Price: Practice

Market Price

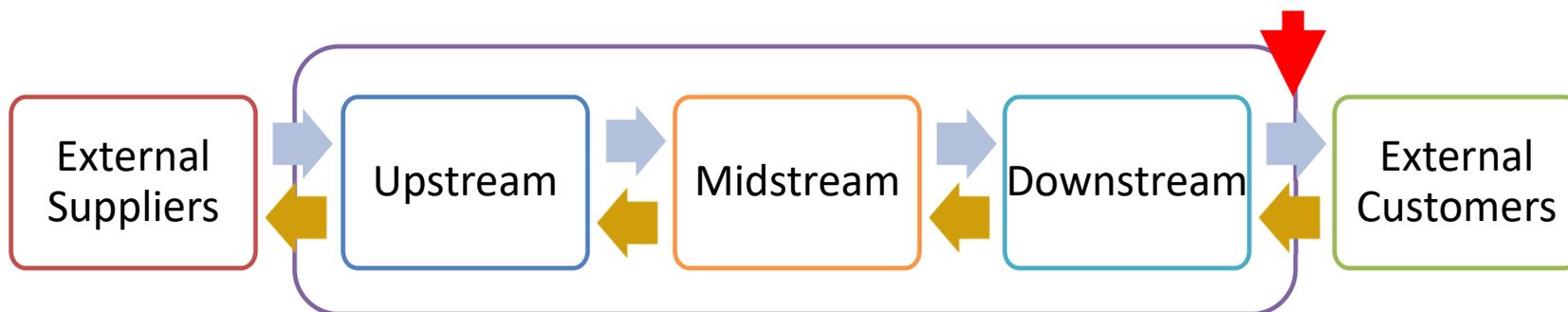
- Usual (textbook) approach:
  - Transfer price = market price of an intermediate product/service that can be and is traded internally.



# Transfer Price: Practice

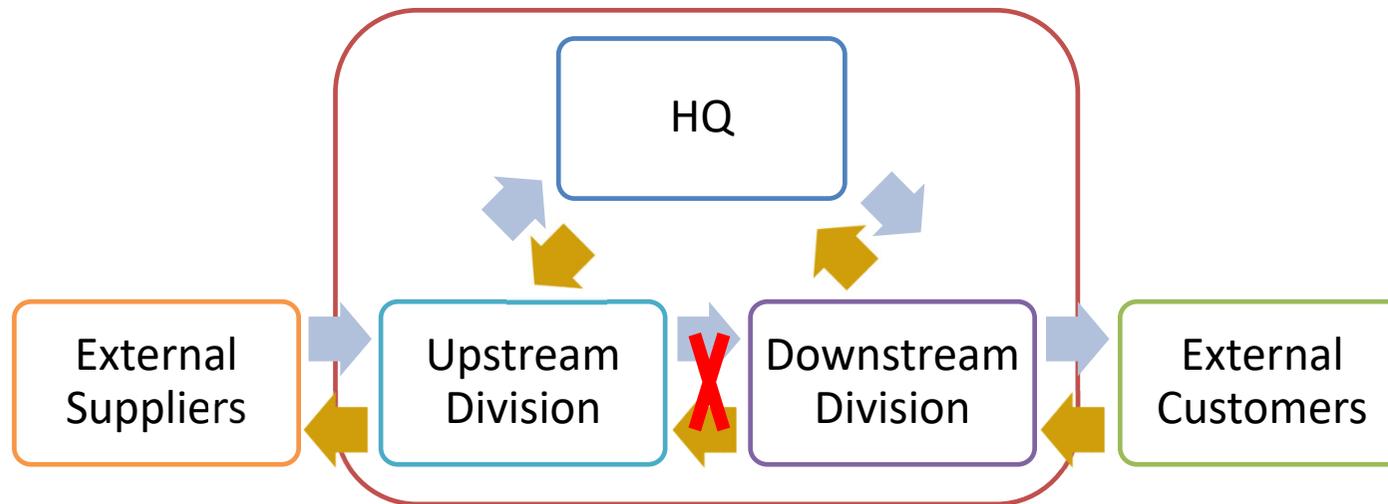
Market Price

- Modern approach (increasingly popular in practice):
  - Transfer price = market price of the final product/service less a “fair” profit margin for the downstream division (“resale-less method”).
  - Estimation of “fair” based on market benchmarks (comparable stand-alone firms).



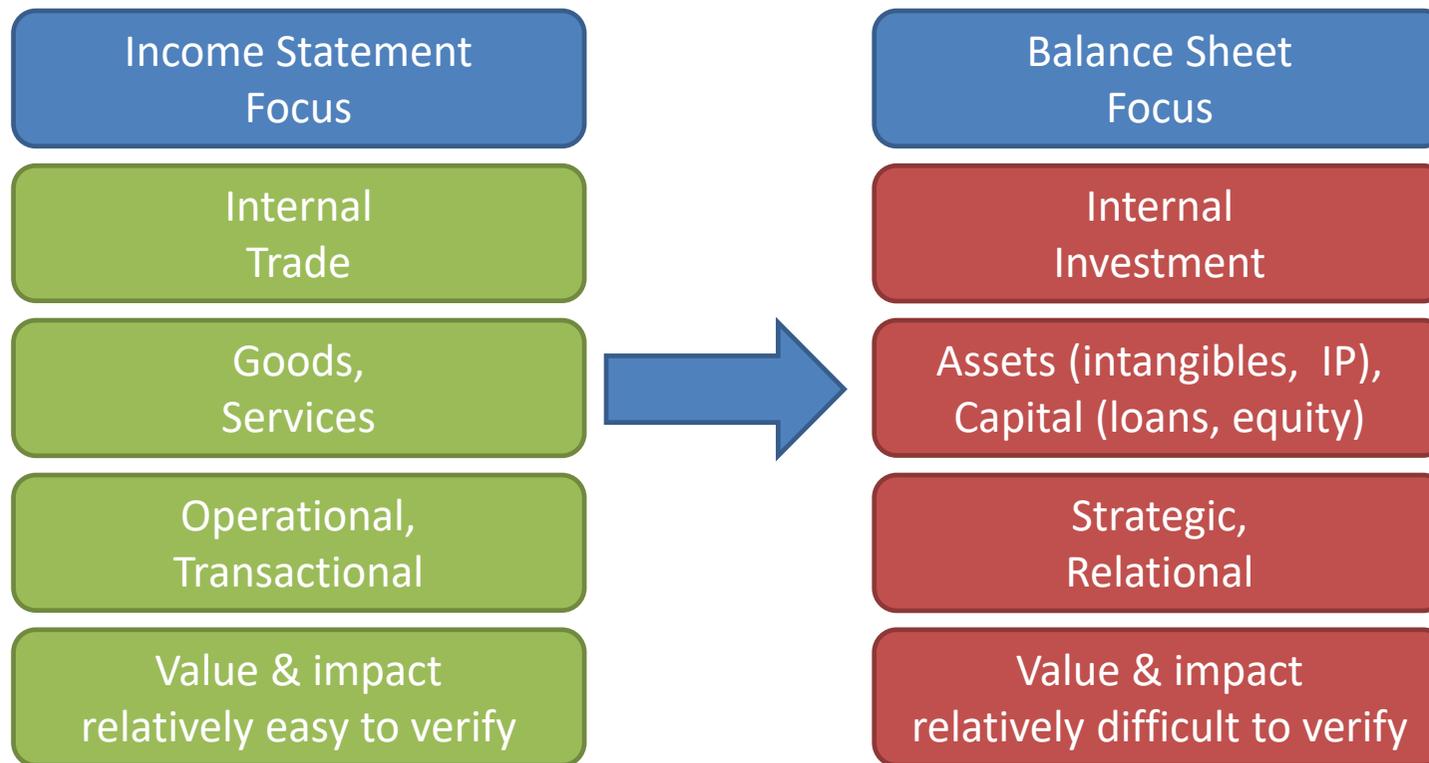
# Transfer Price

- Measures the profit consequences of **internal trade**:

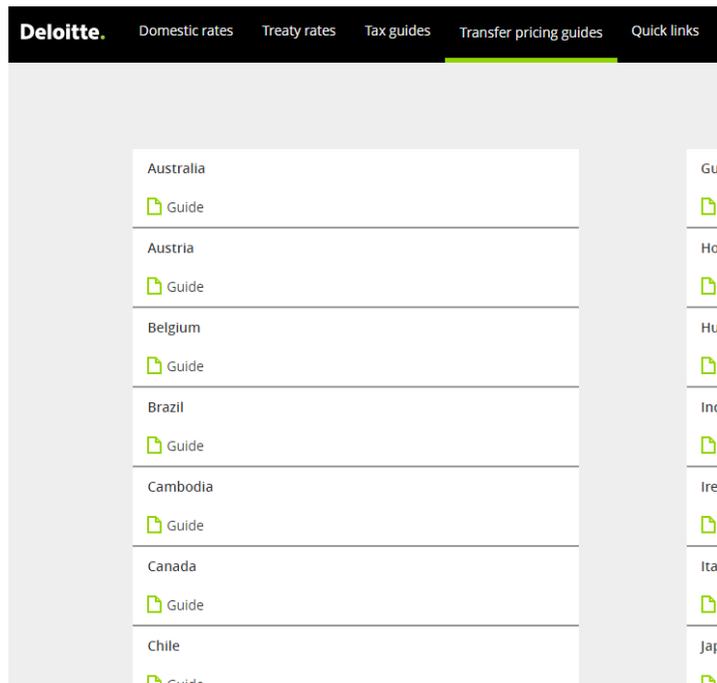


- Decoupling** of upstream and downstream.
- Centralization** of transfer pricing.

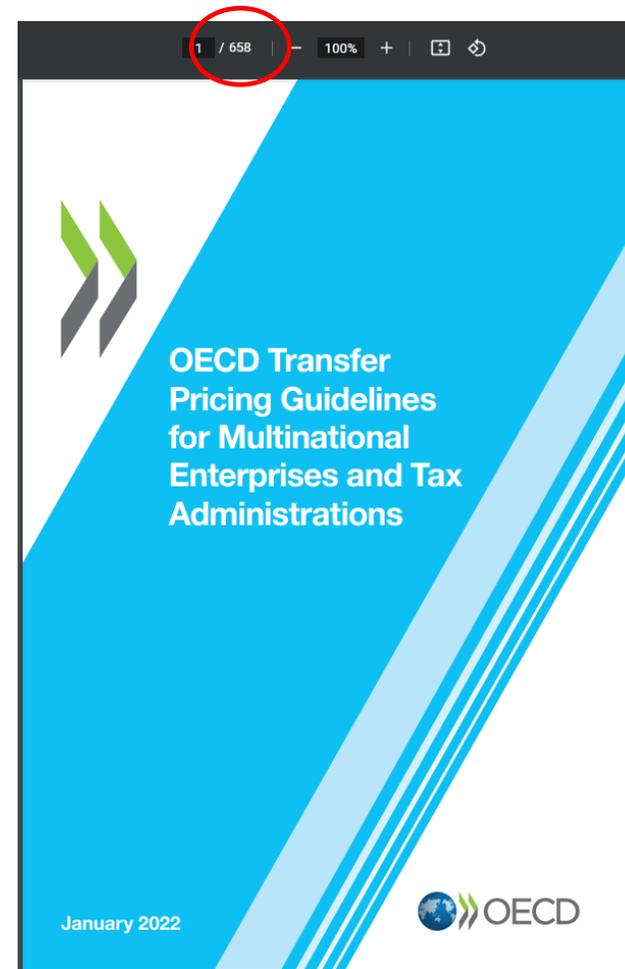
# Transfer Price: Trends



# For the Bookworms



<https://dits.deloitte.com/#TransferPricingGuides>,  
accessed October 24, 2022



<https://www.oecd.org/tax/transfer-pricing/>,  
accessed October 24, 2022

# Global Alignment (1)



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## OECD releases Pillar Two model rules for domestic implementation of 15% global minimum tax

20/12/2021 - The OECD today published detailed rules to assist in the implementation of a landmark reform to the international tax system, which will ensure Multinational Enterprises (MNEs) will be subject to a minimum 15% tax rate from 2023.

The [Pillar Two model rules](#) provide governments a precise template for taking forward [the two-pillar solution](#) to address the tax challenges arising from digitalisation and globalisation of the economy agreed in October 2021 by 137 countries and jurisdictions under the OECD/G20 Inclusive Framework on BEPS.

The rules define the scope and set out the mechanism for the so-called Global Anti-Base Erosion (GloBE) rules under Pillar Two, which will introduce a global minimum corporate tax rate set at 15%. The minimum tax will apply to MNEs with revenue above EUR 750 million and is estimated to generate around USD 150 billion in additional global tax revenues annually.

The GloBE rules provide for a co-ordinated system of taxation intended to ensure large MNE groups pay this minimum level of tax on income arising in each of the jurisdictions in which they operate. The rules create a "top-up tax" to be applied on profits in any jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum 15% rate.

<https://www.oecd.org/newsroom/oecd-releases-pillar-two-model-rules-for-domestic-implementation-of-15-percent-global-minimum-tax.htm>, published December 20, 2021, accessed May 24, 2023

## Global Alignment (2)



### Global corporate tax reform is on the way

*Under the auspices of the OECD, 138 countries have reached an agreement on a fair allocation of taxing rights and a global minimum effective tax rate of 15%. This is a genuine revolution in international tax law. The global minimum tax rate will now be implemented in national law.*

<https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Taxation/Articles/global-corporate-tax.html>, published April 6, 2023, accessed July 27, 2023

# Expected Effect (1)

Opinion Lex

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## Global minimum tax will put the squeeze on investors' returns

The new regime has been cleverly designed to limit tax avoidance

New [international tax rules](#) will restrict the scope to profit from arbitrage and curb a race to the bottom in corporate tax rates. That will remove an important driver of shareholders' returns. Declining tax rates accounted for a hefty 22 per cent of the profit growth of S&P 500 non-financial groups in the three decades to 2019, a study by the Federal Reserve's Michael Smolyansky [has shown](#).

Once fully bedded in, the new 15 per cent minimum tax is expected to force multinationals to pay between 6.5 per cent and 8.1 per cent more tax, according to the OECD.

The impact will be felt most acutely by companies that use tax havens, euphemistically known as investment hubs. These places, where foreign direct investment exceeds 150 per cent of gross domestic product, include Singapore, Switzerland, the Netherlands, Luxembourg and Ireland. They account for nearly a fifth of the profits earned by multinationals — though significantly less of their revenues, assets or employees.

<https://www.ft.com/content/53d7140a-88e4-4c70-8a55-1649d3d629c3>,  
published January 12, 2024, accessed January 12, 2024

# Creative Arrangements (1)

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ANALYTICS



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Blog

## New research from Moody's Analytics reveals far-reaching risk of shell companies

Jan 22, 2024

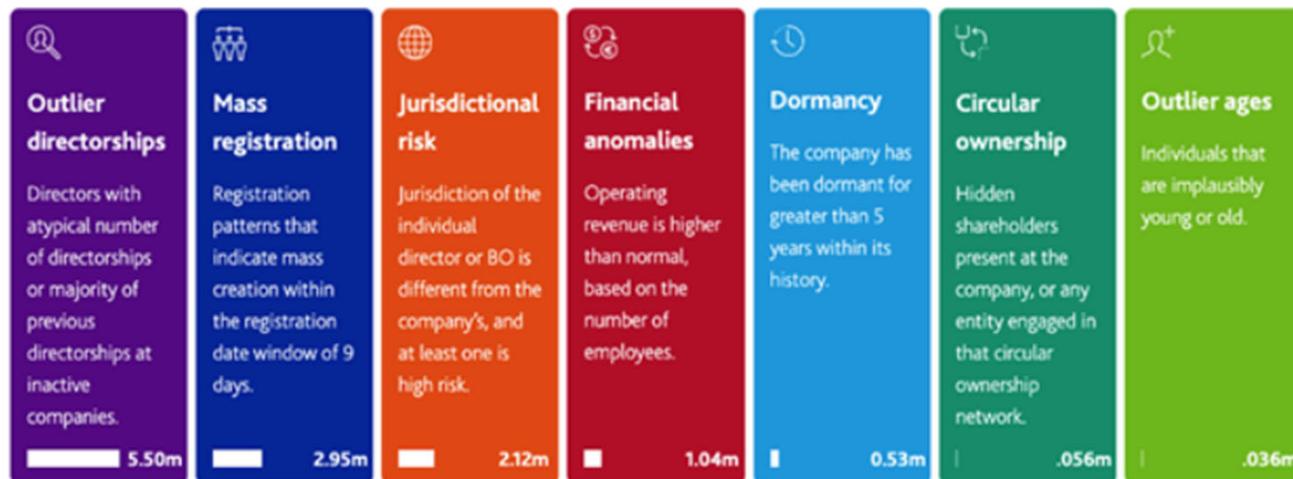
Multiple businesses being registered at the same address is often an indicator of risk. In one instance, the Shell Company Indicator identified over 22,000 companies with a registered address for the "Pyramids" in Egypt for example. Among 'atypical directorships', we found thousands of examples of directors below the age of 5, and 30,000 over the age of 100. One listed director — at 942 years old — would have been born in the 11th century.

<https://www.moody's.com/web/en/us/kyc/resources/insights/new-research-moodys-analytics-reveals-far-reaching-risk-shell-companies.html>, published January 22, 2024, accessed February 6, 2024

# Creative Arrangements (2)



## Shell company flags



(1) Numbers refer to the total number of companies within the Moody's dataset that have or display this outlier or anomalous characteristic.

<https://www.moody's.com/web/en/us/kyc/resources/insights/new-research-moodys-analytics-reveals-far-reaching-risk-shell-companies.html>, published January 22, 2024, accessed February 6, 2024

# Local Tax Havens

## Schatten auf dem Steuerparadies mit Rheinblick

Von Nadine Bös 21.06.2024, 12:07 Lesezeit: 4 Min.



**Monheim am Rhein ist bekannt für geringe Gewerbesteuern und selbstfahrende Busse. Nun macht die Stadt neue Schlagzeilen – mit Verfahren gegen mutmaßliche Briefkastenfirmen.**

<https://www.faz.net/aktuell/wirtschaft/unternehmen/monheim-am-rhein-innerdeutsches-steuerparadies-mit-rheinblick-19797833.html>,  
published June 21, 2024,  
accessed June 21, 2024

# Transfer Pricing!



COMPANIES / GUEST POSTS

Guest Post: Carbon Trading and Transfer Pricing – the Next Frontier for Multinational Corporations



Mark Segal

January 5, 2023

<https://www.esgtoday.com/guest-post-carbon-trading-and-transfer-pricing-the-next-frontier-for-multinational-corporations/>, dated January 5, 2023, accessed January 9, 2023

# Transfer Pricing

## **The benefits of intragroup transfers of carbon credits**

MNCs may seek to minimize overall group carbon tax liability – or the need to purchase credits under an emissions trading system – by moving carbon credits among different related party entities. A key transfer pricing consideration would be how to price the carbon credits. The MNC would need to consider the price of the credit of a willing buyer and seller, which may be different in compliance and voluntary markets. In terms of pricing, the appropriate market price – such as spot prices at different dates and potentially forward price curves – would need to be evaluated to understand alternatives. It would also be important to consider whether aligning emissions and credits would benefit the MNC. For example, a benefit to its reputation that allows it to charge a premium price or boost sales.

<https://www.esgtoday.com/guest-post-carbon-trading-and-transfer-pricing-the-next-frontier-for-multinational-corporations/>, dated January 5, 2023, accessed January 9, 2023

# Carbon Price Avoidance & Response



ENVIRONMENT / GOVERNMENT

## UK to Launch a Carbon Tax on Imports

The UK government announced that it will introduce a carbon border adjustment mechanism (CBAM) by 2027, establishing a carbon tax on imported goods targeted at a series of key emissions-intensive industries, aimed at equalizing the carbon price paid by UK producers with those outside the UK, and avoiding "carbon leakage," or shifting of production of carbon-intensive goods to jurisdictions with less stringent emissions reduction policies.

<https://www.esgtoday.com/uk-to-launch-a-carbon-tax-on-imports-by-2027/>, published December 19, 2023, accessed December 20, 2023

# Compagnie du Froid: Agenda (b)

1. Additional Challenges
2. Transfer Price Fundamentals (only if time allows)
3. Transfer Price & Effects

## Exh. 5: Transfer Price

	Cost of ingredients	Ice-cream Cost per litre	Total (in '000 €)
Volume transferred (in '000 liters)			603
Actual Costs (in €)			
Dairy ingredients	2.76	1.98	1,194
Other ingredients	1.56	0.69	416
Labor	0.09	0.09	57
			1,667
Allocated Fixed Costs (in €)			
Other costs		0.46	279
Depreciation		0.09	56
S&A expenses		0.04	23
			358
5% profit margin		0.17	101
<b>Total transfer price</b>		<b>3.53</b>	<b>2,126</b>

## Exh. 5: Transfer Price

- In your opinion, what does (should) the transfer price achieve?
- Management of business:
  - Direct effect: share/split overall profit.
  - Reflect the main sources of value creation.
  - “Left pocket-right pocket”.
- Leadership of people:
  - Indirect effect: increase overall profit.
  - Communicate the main sources of value creation.
  - Incentivize collaboration.
  - Align towards value creation.

# Exh. 5: Transfer Price

	Numbers	People

## Exh. 5: Transfer Price

	Numbers	People
Full Cost (incl. fixed cost)	F: artificial revenues. S: artificial costs.	F: help out. S: fix your problem.
Profit margin	As above: profit shifting.	As above.
Actual costs (vs. budgeted costs)	F: neutral. S: absorb F's (in)efficiencies	F: no efficiency incentives. S: no planning security.

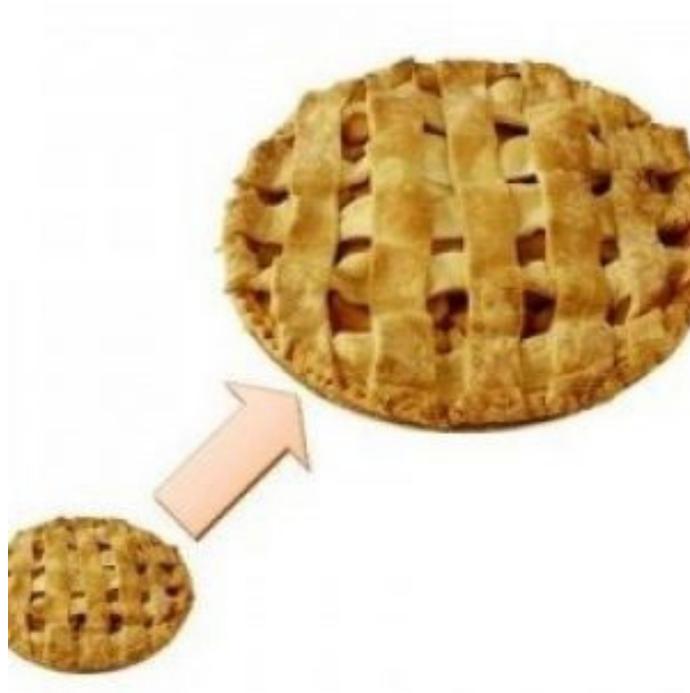
## Value Sharing ...

- “Transfer Price” ... tradeoffs like in a zero-sum game?



## ... or Value Growing?

- “Transfer Price” – how to create a non-zero sum game and “grow the pie”?



## Profit Impact (Ice cream)

<b>Actual (production in France)</b>	<b>France</b>		
	<b>Total</b>	<b>Self</b>	<b>To Spain</b>
Volume ('000 liters)	4,618	4,015	603
Revenues	20,005	17,879	2,126
Variable Cost	-12,766	-11,099	-1,667
Subcontracted Transportation			
Contribution Margin	<u>7,239</u>	<u>6,780</u>	<u>459</u>

- **Revenues & Variable Cost** in France:
  - According to Exhibits 2 and 5.

# Profit Impact (Ice cream)

Actual (production in France)	France			Spain		
	Total	Self	To Spain → From France	From France	Self	Total
Volume ('000 liters)	4,618	4,015	603 →	603	2,972	3,575
Revenues	20,005	17,879	2,126 ↘	2,616	12,891	15,507
Variable Cost	-12,766	-11,099	-1,667 ↘	-2,126	-8047	-10,173
Subcontracted Transportation				-77	0	-77
Contribution Margin	7,239	6,780	459	413	4,844	5,257

- **Revenues in Spain:**

- Prorated proportional to volume.
- $12,891 \text{ €} / 2,972 \text{ l} = 4.34 \text{ €/l} \Rightarrow 603 \text{ l} * 4.34 \text{ €/l} = 2,616 \text{ €}.$

## Profit Impact (Ice cream)

Hypothetical (production in Spain)	France			Spain		
	Total	Self	To Spain	From France	Self	Total
Volume ('000 liters)	4,015	4,015	0	603	2,972	3,575
Revenues	17,879	17,879	0	2,616	12,891	15,507
Variable Cost	-11,099	-11,099	0	-1,633	-8,047	-9,680
Subcontracted Transportation				0	0	0
Contribution Margin	6,780	6,780	0	983	4,844	5,827

- **Variable Cost** in Spain:
  - **Extrapolated** from actual cost of self-produced ice cream.
  - $8,047 \text{ €} / 2,972 \text{ l} = 2.71 \text{ €/l} \Rightarrow 603 \text{ l} * 2.71 \text{ €/l} = 1,633 \text{ €}$ .

# Profit Impact (Ice cream)

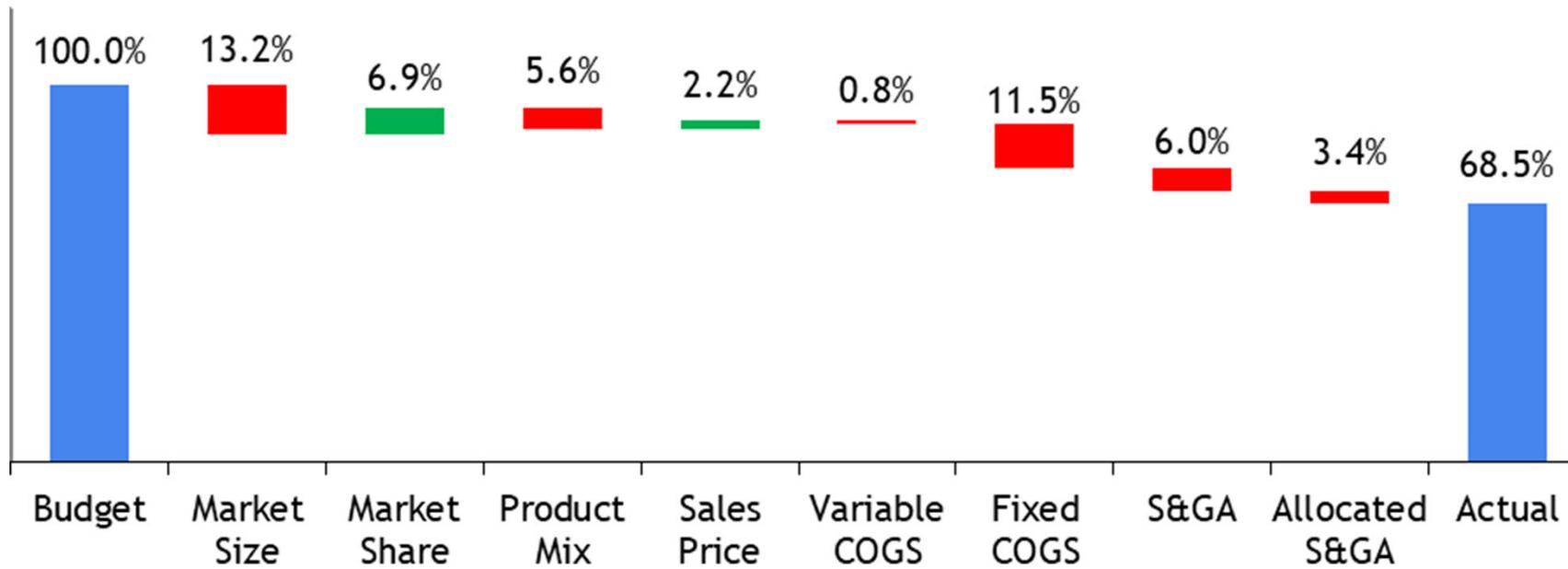
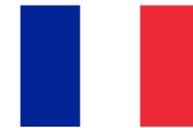
Incremental Effect (Contribution Margins)	France			Spain		
	Total	Self	To Spain	From France	Self	Total
Actual	7,239	6,780	459	413	4,844	5,257
Hypothetical	6,780	6,780	0	983	4,844	5,827
Incremental Effect	459	0	459	-570	0	-570

- Effective Cost for Compagnie du Froid -111
- “Left pocket – right pocket” ...
  - Positive impact on France’s pocket.
  - Negative impact on Spain’s pocket.
- ... and “out of pocket”:
  - Overall, a negative impact on Compagnie du Froid.

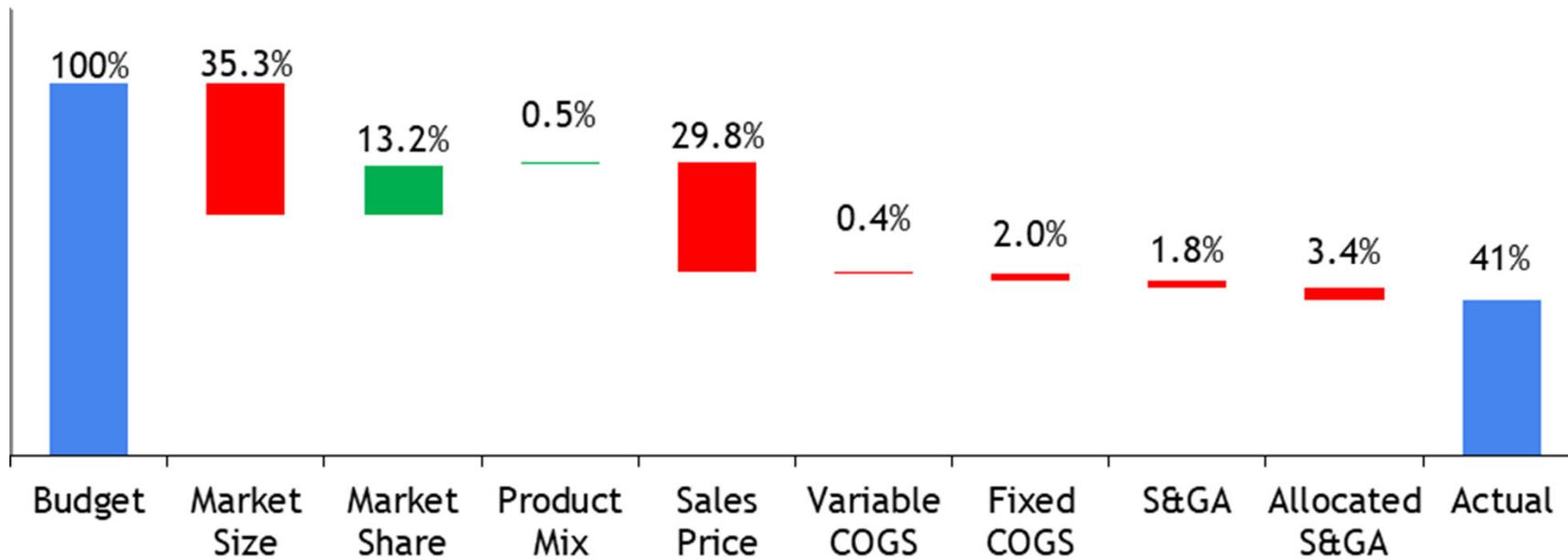
# Compagnie du Froid: Agenda (b)

1. Additional Challenges
2. Transfer Price Fundamentals (only if time allows)
3. Transfer Price & Effects
4. **France & Spain**

# France (ex-Transfer, ex-Distribution)



# Spain (“as if”)



# Caveats: Interpretation

- **Controllability**
  - Signal jamming: one variance, multiple possible causes.
  - Framing: control the trigger vs. control the response.
- **Benefit of hindsight**
  - Desirable decision vs. undesirable outcome.
  - Other decision ... hypothetical consequences.
- **Tradeoffs**
  - Correlations.
- **Decisions & actions**
  - Responsiveness: immediate vs. delayed.
  - Effects: transitory vs. permanent.
- **Numbers vs. People**

# Compagnie du Froid: Agenda (b)

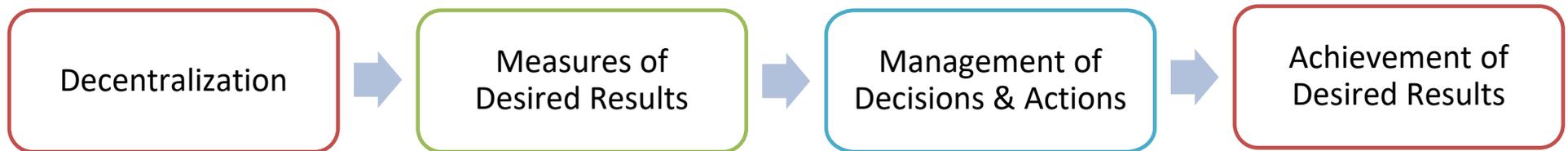
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# Compagnie du Froid: Agenda (b)

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# Logic of “Management by Objectives”

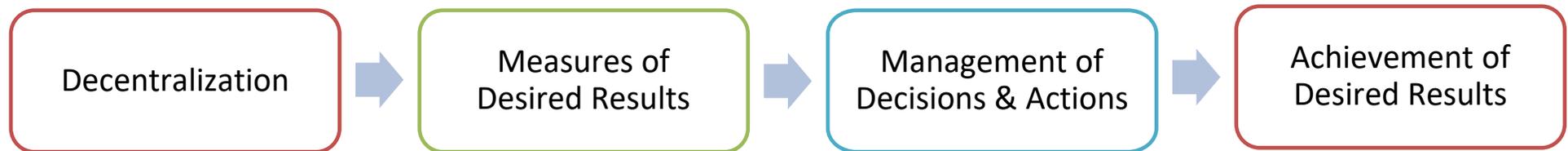
- If we select aligned results measures and we let people act freely, then ...



... voilà! We get desired performance.

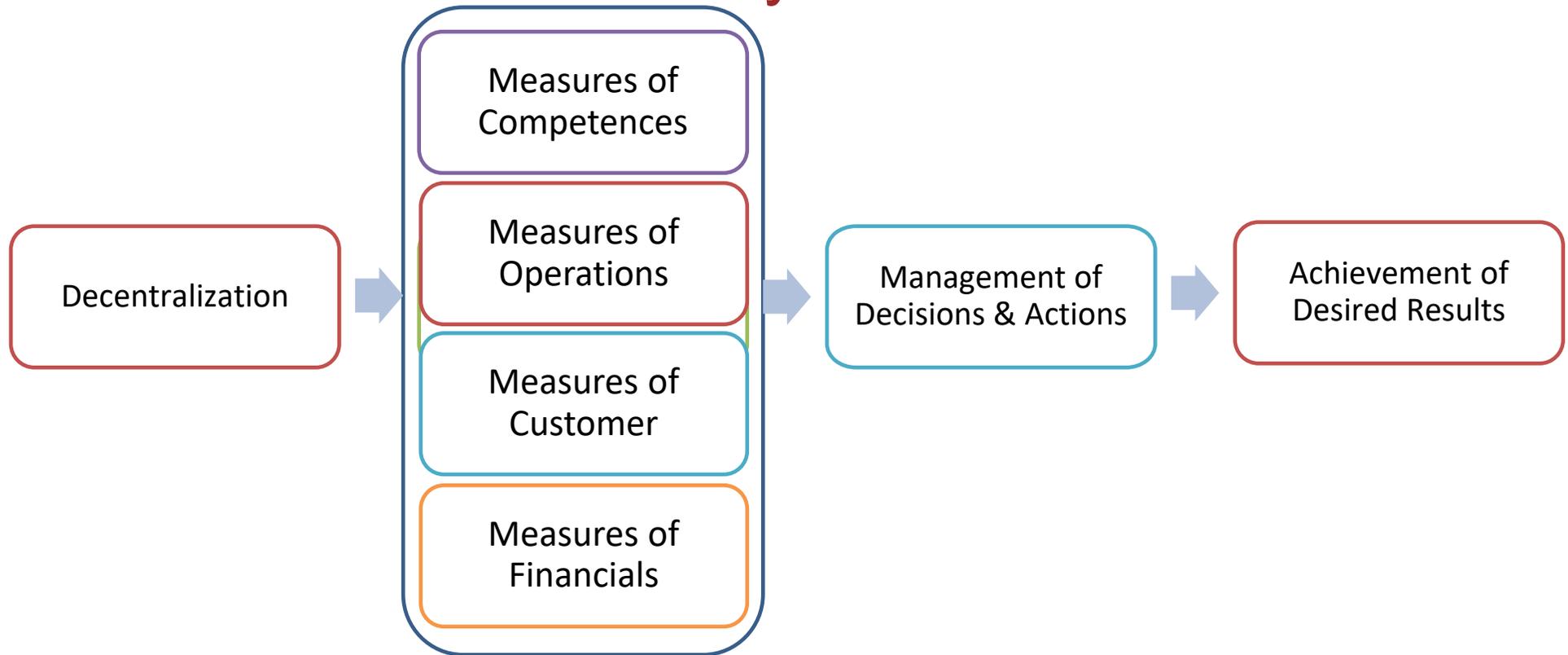
## But Wait ...

- Decentralization is one aspect of the organizational conditions that provide the context for decisions.

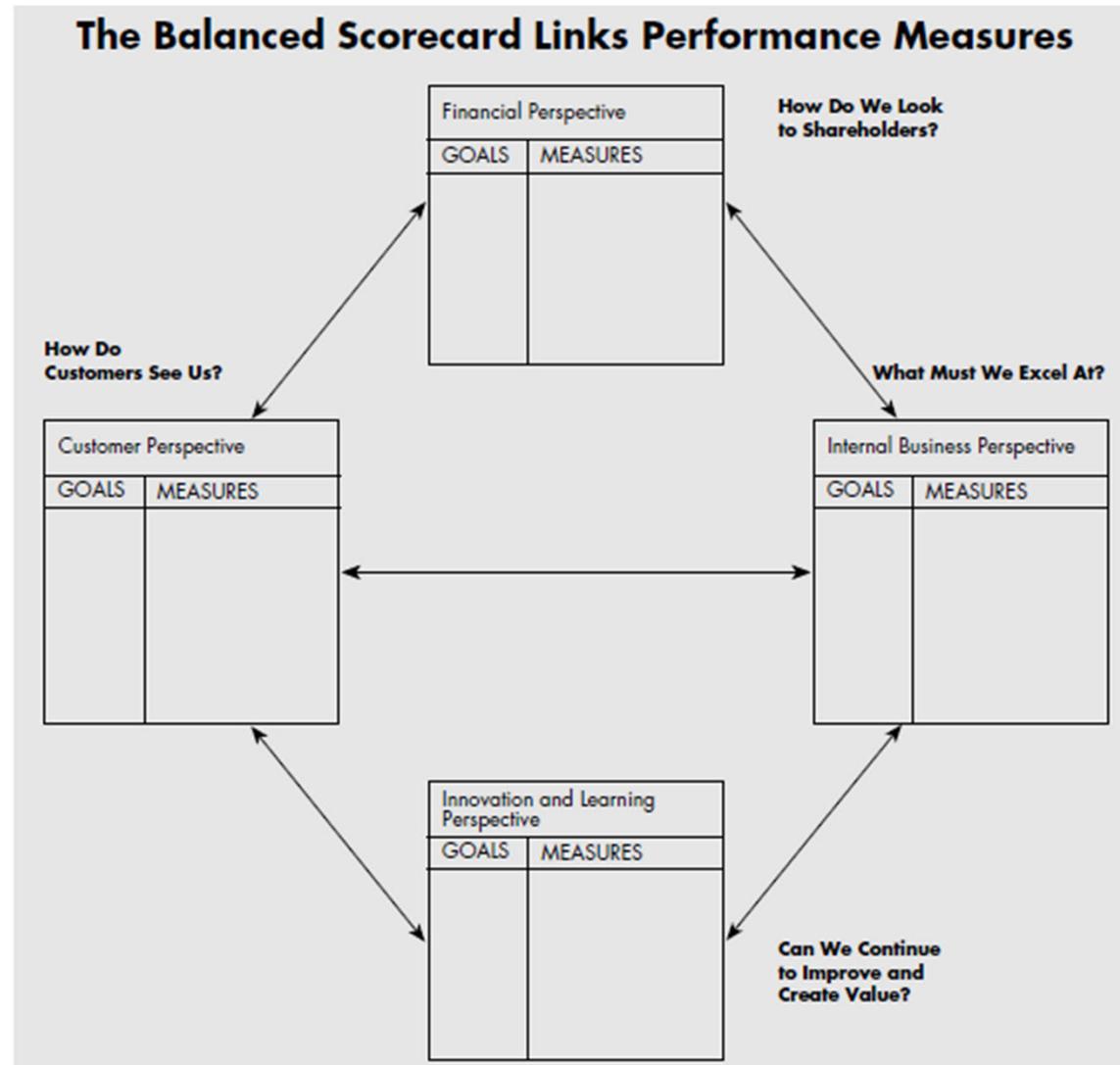


- Results Measures are *one* type of performance measures that capture the consequences of decisions. And they do so at the “end of the process”.

# Performance Measure System



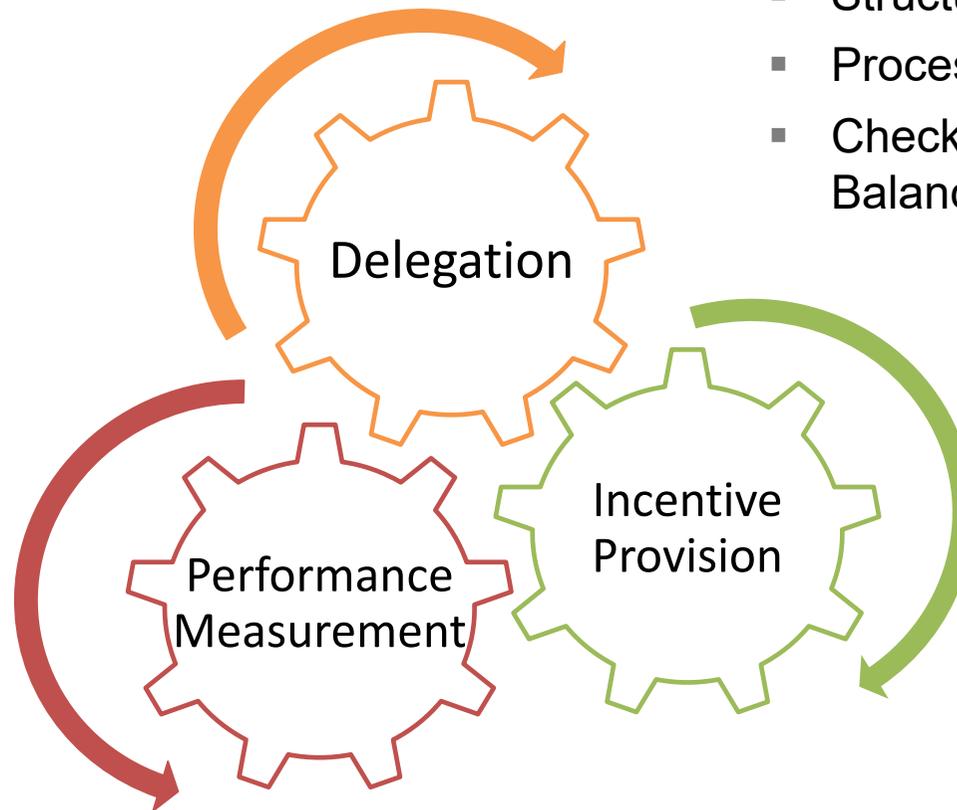
# A Classic Tool



Kaplan & Norton (1992)

# Organizational Governance

- Measures
- Targets
- Reporting
- Evaluation

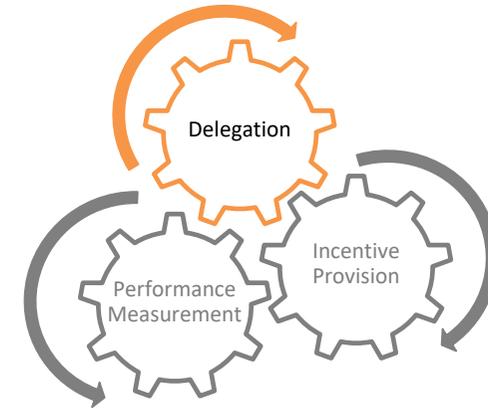


- Structures
- Processes
- Checks & Balances

- In-/Formal
- Ex-/Implicit
- Individual & Team

# Popular Recommendations

- **Strategy:**
  - Clarification.
  - Communication.
- **Decentralization:**
  - Lateral communication & collaboration (synergies).
  - Define policies, set limits.
  - Core business vs. non-core business (F: distribution).



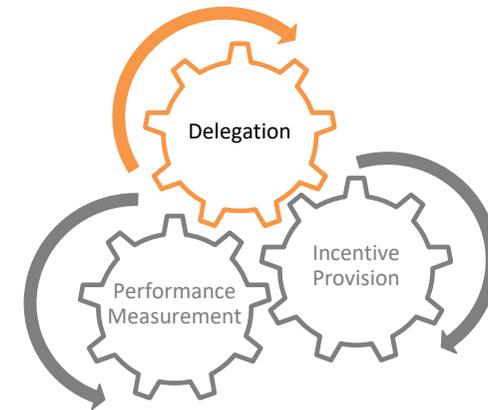
# Other Recommendations

- **Standardization:**

- Products.
- Production processes.
- Best practices.

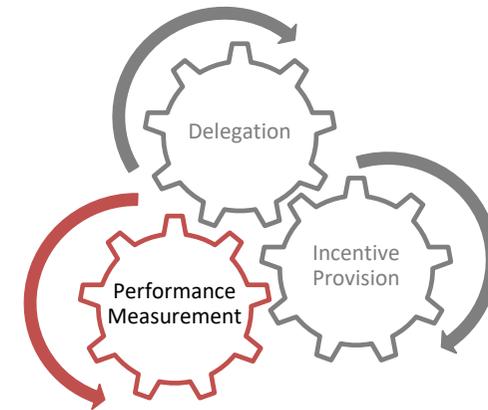
- **Restructuring:**

- Capacity management (flexible use of productive resources).
- Centralize production in Spain?
- Functional or matrix structure.



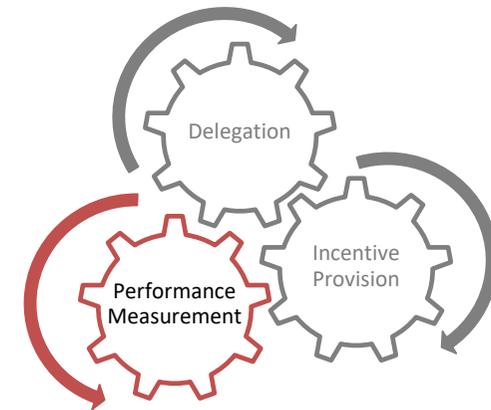
# Popular Recommendations

- **Budget:**
  - Process.
  - Outcome.
  - Frequent, rolling updates.
- **Transfer Price:**
  - Motivation of cooperation, synergies.
  - Variable Cost + profit margin.
  - Dual transfer price.
  - Relevance (one-time)?



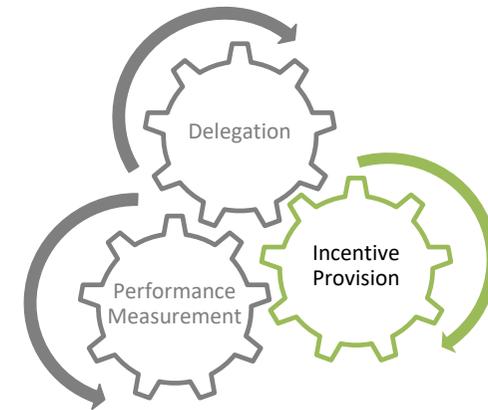
# Other Recommendations

- **Transfer Price: food for thought.**
  - Does not matter: one time thing!?
- **Performance measures:**
  - Changes (growth) vs. levels.
  - Non-financial KPIs: strategy, innovation, collaboration (360°?), capabilities, ...
- **Other:**
  - Allocation HQ.



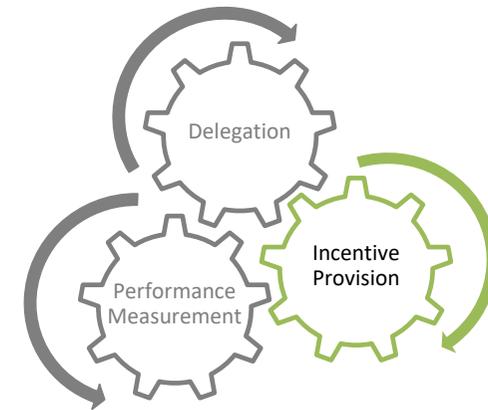
# Popular Recommendations

- **Hierarchical Mix:**
  - Company profit.
  - Regional profit.
  - Individual goals.
- **Sensitivity:**
  - Stretch targets (no “caps”).
  - Progressive % rates.



# Other Recommendations

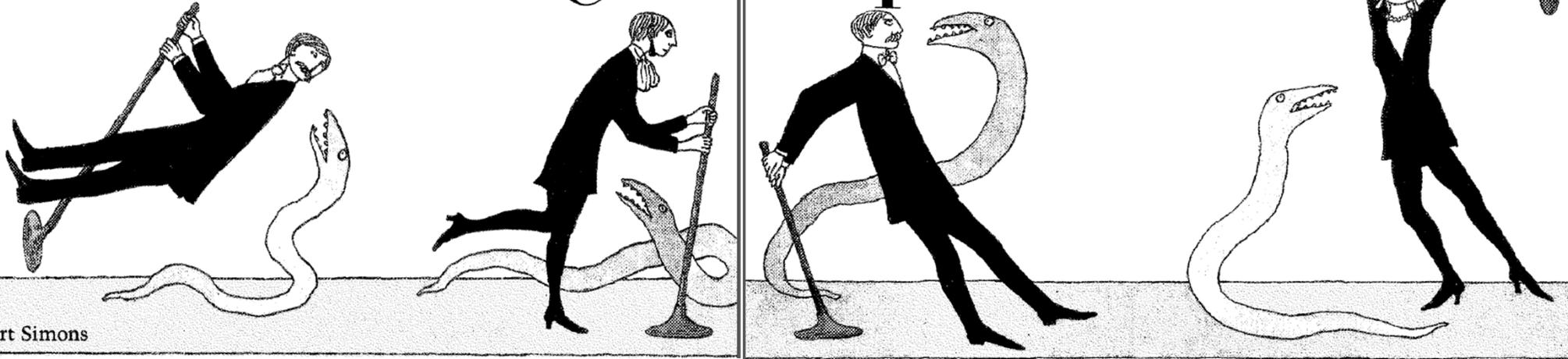
- **Qualitative Mix:**
  - Financial incentive.
  - Non-financial incentive.
- **“Keep as is”:** food for thought ...:
  - Individualism/egoism would have made things worse.
  - Bonus/evaluation not tied to budget avoids gaming.



# More than KPIs

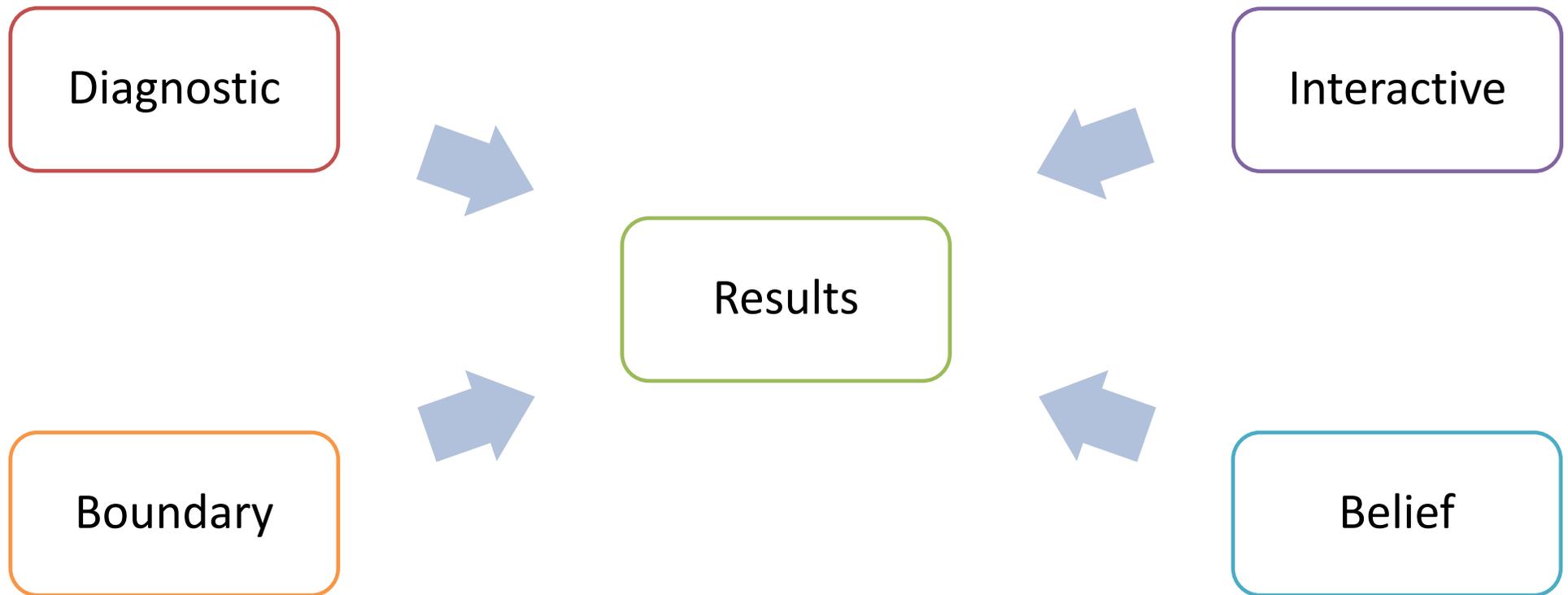
*How can managers promote innovation while avoiding  
unwelcome surprises?*

## Control in an Age of Empowerment



by Robert Simons

# Governance Systems: “Levers of Control”



# Governance Systems: “Levers of Control”

Diagnostic

- Purpose: results control & management-by-exception.
- Tools: KPIs, targets & budgets, progress reports, project monitoring systems.
- Focus: implementation of strategy.

Das ist ein traditionelles Verständnis von Controlling  
(und wird hauptsächlich innerhalb der Controlling Abteilung getan)

# Governance Systems: “Levers of Control”

Interactive

- Purpose: communication & feedback.
- Tools: management process, committees, roundtables, field visits, field days.
- **Focus: validation of strategy** (key success factors, returns & risks/uncertainties).

# Governance Systems: “Levers of Control”

- Purpose: “corporate ethics”  $\Rightarrow$  strategic, professional & ethical “off limits”.
- Tools: “black list”, honor code, code of business conduct, operational guideline, compliance manual, rules of the game.
- Focus: implementation of purpose, goals & objectives.

Boundary

# “Governance Systems: “Levers of Control”

- Purpose: provide aspirational guidance for positive decisions and actions.
- Define core values, attitudes, purpose, direction
- Tools: mission statement, vision statement, credo, “Who we are”.
- Focus: validation of purpose, goals & objectives.

Belief

# Compagnie du Froid: Agenda (b)

1. Additional Challenges
2. Transfer Price Fundamentals (only if time allows)
3. Transfer Price & Effects
4. France & Spain
5. Typical Recommendations
6. Overall Conclusions

# Management-by-Mood-Swings



© marketoonist.com

# Conclusions: Management (1/2)

- **Reasons** for change?
  - “It’s the weather”!!
  - Unique situation (in principle, it will not repeat).
  - Isolate managers from other parts of the firm.
- **Moment** for change?
  - Requires cooperation, not competition.
  - Italy and France have always benefited from Spain (ideas, innovation, ...). Now, for once, Spain is the one in need ...

# Conclusions: Management (2/2)

- **Real business problems?**

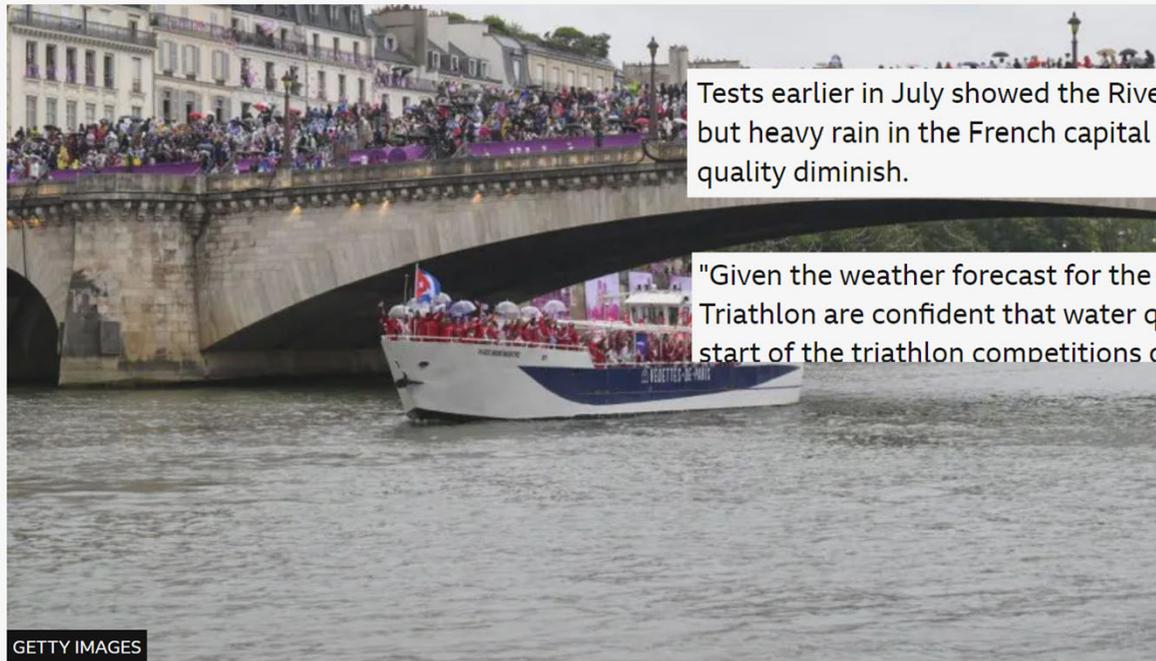
- Exposure to luck (weather is the key driver of profit and profit-at-risk): rethink the business model.
- New corporate venture: cost (\$) and opportunity cost (management attention).
- Diversification into logistics: implied change of the corporate mission.

- **Real management problems?**

- Delegation vs. interference: motivation vs. demotivation.
- Leadership & corporate culture: hands-off vs. hands-on, cooperative vs. competitive.
- Design vs. use of accounting & control tools: “excellence of execution is a competitive advantage” – how true!

# Your Plans vs. The Weather

## River Seine pollution stops triathlon swim training



Tests earlier in July showed the River Seine was clean enough for swimming but heavy rain in the French capital on Friday and Saturday has seen the quality diminish.

"Given the weather forecast for the next 36 hours, Paris 2024 and World Triathlon are confident that water quality will return to below limits before the start of the triathlon competitions on 30 July."

<https://www.bbc.com/sport/olympics/articles/cn05nxv2z9po>,  
dated July 28, 2024,  
accessed August 5, 2024

GETTY IMAGES

The triathlon is due to start on 30 July provided water quality in the River Seine is of the required standard

# All's Well That Ends Well ...



The New York Times

Account ▾

PARIS DISPATCH

## *You Can Swim in the Seine Again. Trust Me. I Just Did.*

First, France cleaned the polluted river so that Olympians could swim there. Now, a year later, it is opening three sites for locals to plunge in.

<https://www.nytimes.com/2025/07/05/world/europe/france-paris-seine-river-swimming.html>,

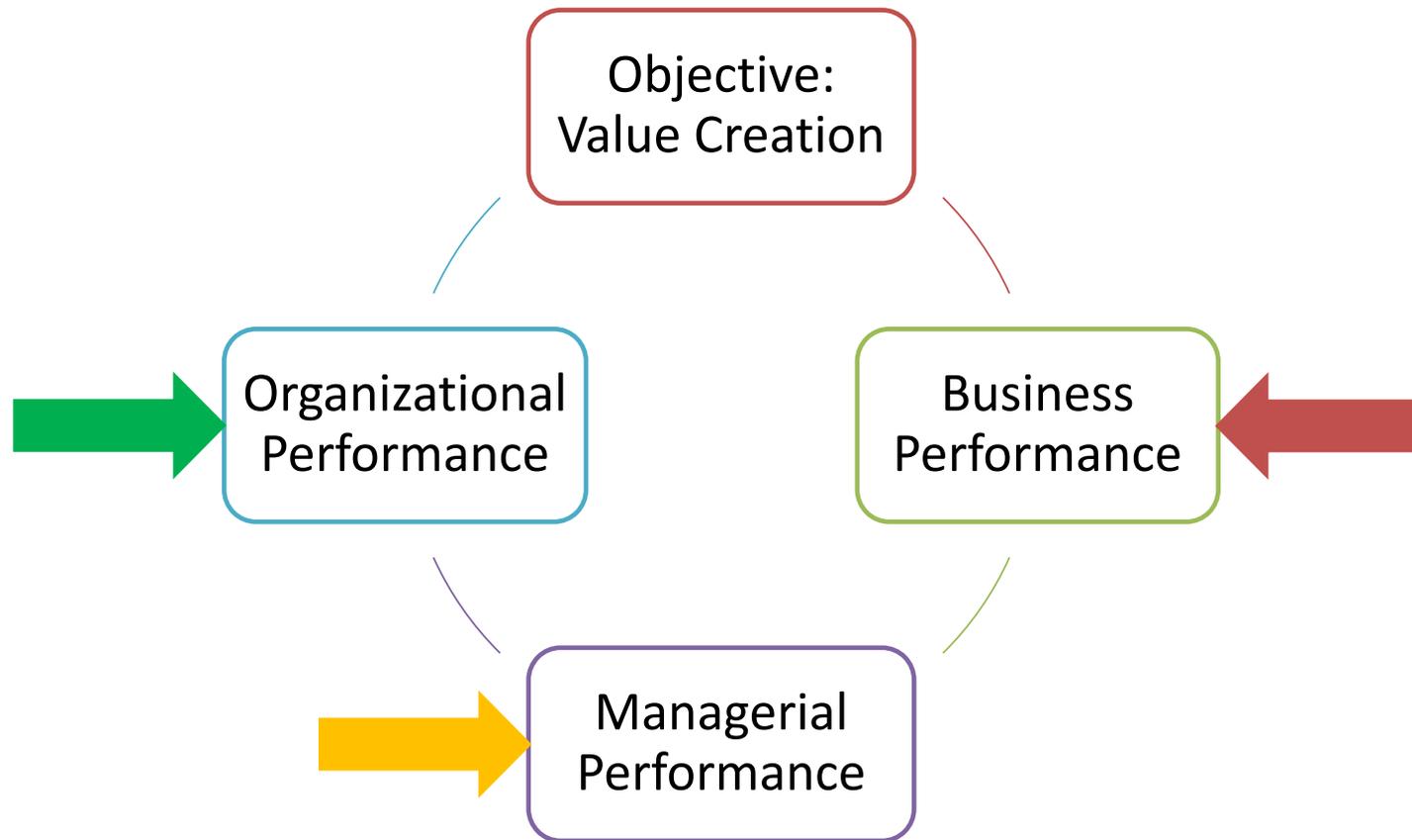
published July 5, 2025, accessed July 15, 2025.



# Compagnie du Froid: Agenda (b)

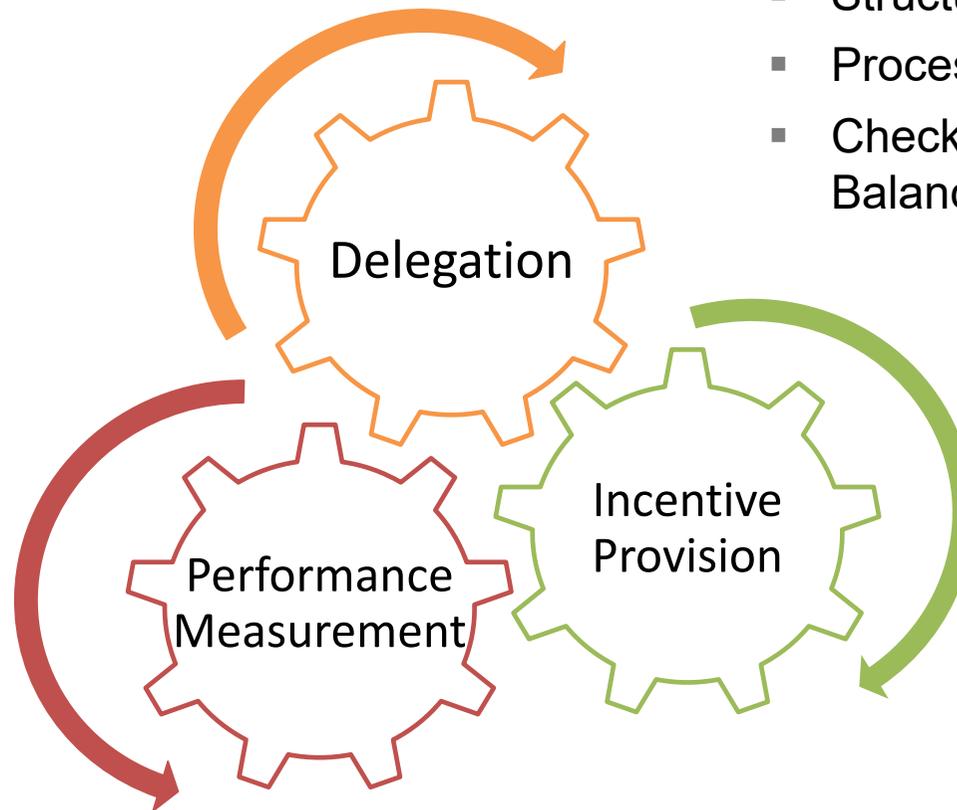
1. Additional Challenges
2. Transfer Price Fundamentals (only if time allows)
3. Transfer Price & Effects
4. France & Spain
5. Typical Recommendations
6. Overall Conclusions
7. Summary

# Value Creation & Performance



# Organizational Governance

- Measures
- Targets
- Reporting
- Evaluation



- Structures
- Processes
- Checks & Balances

- In-/Formal
- Ex-/Implicit
- Individual & Team

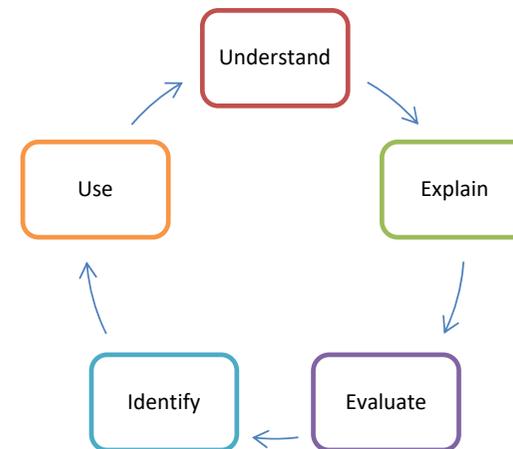
# Budget Cycle



- **Budget (ex-ante):**
  - Plan, expressed in accounting numbers.
  - Amounts that *should be* earned and spent.
- **Budgeting Process:**
  - Importance for management.
  - Numbers & people.

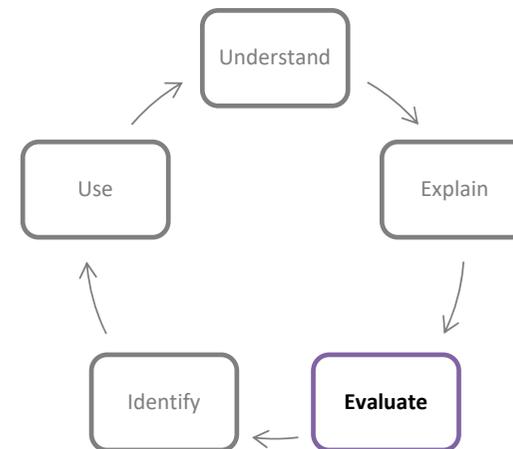
# Variance Analysis

- Theme: isolate the incremental impact of ...  
... the deviation (actual vs. plan) of each identifiable profit driver ⇒ step-by-step:
  - Understand impacts.
  - Explain reasons.
  - Evaluate businesses & managers.
  - Identify likely future.
  - Use for corrective actions.



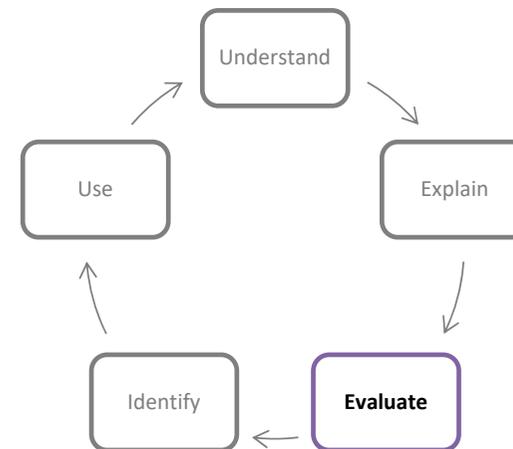
# Performance Evaluation

- Focus: **numbers** vs. **people**.
  - Division/unit: trajectory of the business?
  - Manager: decisions & actions?
- Application & consequences:
  - Inputs: objective vs. subjective.
  - Attitude: serious vs. lenient.
- Important distinctions:
  - **Business** ≠ **manager**!
  - **Responsibility** ≠ **fault**!



# Performance Evaluation

- **Make sense of measured performance ...**
- **Inclusiveness: individual vs. team.**
  - Example: divisional vs. corporate profit.
  - Effort & competition vs. cooperation & free-riding
  - Controllability vs. risk.
- **Performance measure: choice.**
  - Financial/accounting.
  - Non-financial.

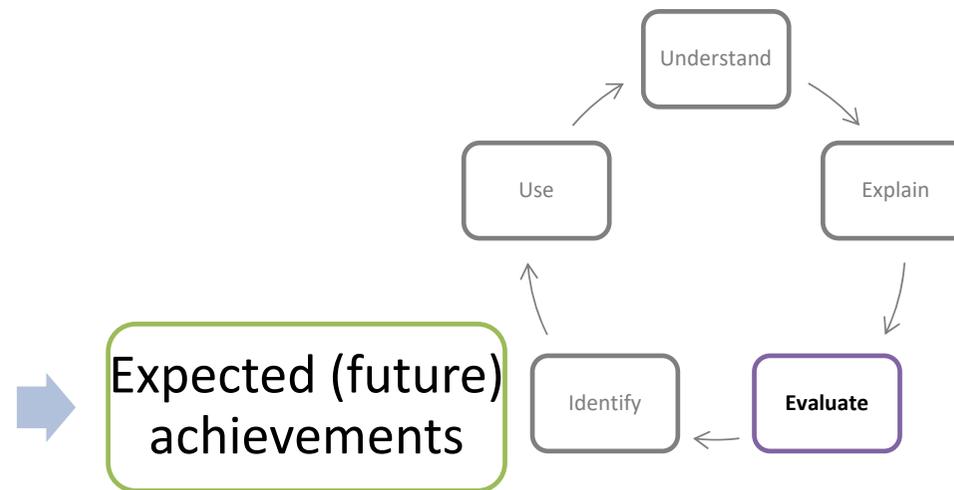


# Performance Evaluation

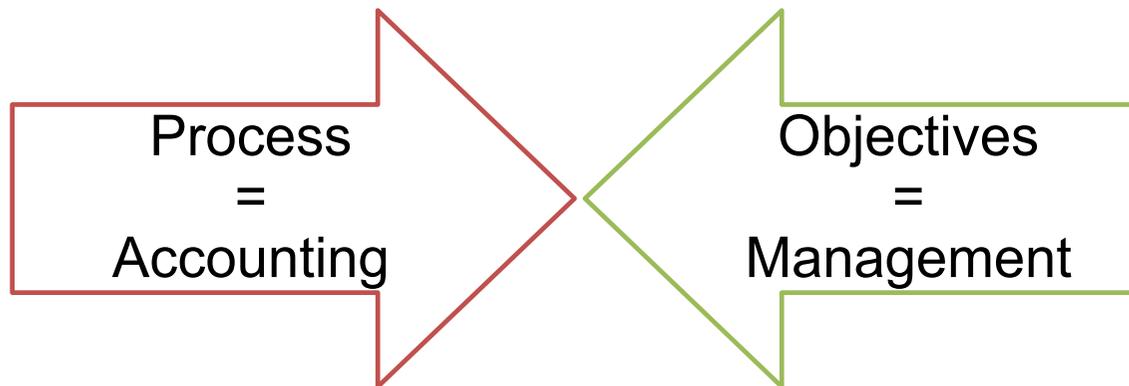
- Make sense of measured performance ...

... and of everything else that might matter *for the future*:

- Motivation.
- Commitment.
- Learning & Potential.
- Skills set.



# VA Limitations



- No single variance is attributable to one **single cause**.
- No single variance **automatically** triggers (or: should trigger) one specific **response**.
- Rather: good judgments!

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