

FUNDAMENTAL APPROACHES TO COMPANY PERFORMANCE MEASUREMENTS

Vojtěch BARTOŠ

The systems used to measure company efficiency are one of the most important management tools. In the arena of global competition and constant environmental changes, the focus is permanently put on the future - strategic company efficiency that moves away from the now out-dated systems, such as those based on DuPont's philosophy. This contribution is focused on basic implementation of company efficiency management.

Key words: company performance, company efficiency, performance measurement systems

Introduction

In the past 18 years the competitive environment of Czech companies, which relatively quickly faced global competition and had to rebuild, changed rapidly. In the process of these changes management plays the key role using new methods and management tools. Performance measurement systems are a significant management tool.

Under global competition and permanent changes conditions the focus is put on possibilities of measuring company strategy performance, which was not possible by systems based on DuPont's schema philosophy.

At the beginning the notion of "performance" is to be defined. From our point of view it is beneficial to accept EFQM definition (European Foundation for Quality Management)¹: "Performance is a level of reached results by individuals, groups, organizations and their processes". So, if we want to measure performance, we have to do so in comparison with defined so-called goal result value. On company level goal values come from strategy, on process level – usually derive from benchmarking of main competitors.

1. Company performance evaluation

Most managers in Czech economy still especially use economic ratios to evaluate company performance and its parts. Some of them due to their pure economic orientation have gone so far that they are trying to influence those ratios directly instead of influencing company quality performance, which creates ratio values. Current company information systems that are overloaded with economic information also contribute to this approach. It is caused by the fact that it is possible to easily measure economic and financial ratios and a part of data gained from company accounting.

Other managers specialized rather in material problems and having weaker knowledge of economy and finance are mostly overloaded with complex results of financial analysis, which are supplied by an information system. Then they usually do not use their results of financial analysis or they use them in quite inefficient way.

Also an owner prefers the economic approach to company performance measurement. It is necessary to realize that the owners put their investments into a company with an expectation of a corresponding rate of return. In owner's point of view, a company is a "money machine" and, in case of not fulfilling its role, the owners see the cause in management inability; and from their point of view they are right.

Professional managers have to be able to manage a company in a way to create values that will make return to the owners, which makes up to or overtakes their expectations.

However financial ratios are indispensable for performance measurement. Only those refer to managers about information if the company creates values and enables managers to find out if their arrangements contribute to value creation. Their fundamental weaknesses are financial information that reflects management decision impacts of a past period; and its development is effected by a whole range of influences, which cannot be specified. Complex financial ratios can also be very hardly connected with a development of basic internal processes and other areas conditioning company success.

That is why development and improvement of performance measurement systems proceed by editing financial ratios with further non-financial ratios, by which companies were trying to measure and evaluate development of basic success factors of individual company strategic areas.

In the 80-ties of the 20th century complicated ratio systems for performance measurement were created in world leading companies, which in many cases proved to be inefficient just by trying to create a perfect system and therefore big amount ratios.

To identify a ratio and measure its value is not a problem. Far bigger problem is to identify what value must be reached and in which cases it is practically impossible to identify dependence between non-financial and financial criterions. To this we need statistics, which elaboration takes years. We should compare the value of the most important ratios with our competition via benchmarking.

Gradually it comes out that success in performance measurement was with companies, which chose limited amount of ratios in whose selection top management took part. In this time a range of new ratios was implemented and verified and evaluation methodology was worked out. The principle of balanced financial and non-financial criteria was pushed through.

The reason of a great interest in the new ratio system consists of the fact that traditional systems that often concentrate on top financial ratios in strong dynamic and turbulent environment failed. The study in *Harvard Business Review* in 1999 run in the USA proves that market dynamics, on the one hand, often causes collapse of traditional systems and, on the other hand, is starting motive for using non-financial ratios. Often raised criticism says that due to information overload by financial ratios there is not relevant information available. In concepts "Performance measurement" the weakness of traditional systems is the starting point for improvement and expansion. The following critical points are mentioned (Kaplan R. S., Norton D. P., 2001):

- Short character of financial ratios
- Financial ratios orientation to the past
- Non-existing linkage to strategy
- Almost none claim consideration of share holders and other third persons
- Insufficient measurements of performance improvement and its potentials

However, dissatisfaction with purely financial ratios is known. Already in the 50-ties years in the 20th century they were trying to find out key indicators of company performance. It resulted in non-financial ratios, which are used also in current approaches to performance measurement. Since the 80-ties scientists and practitioners in controlling and management accounting fields especially in English-American space inquire with problems, which got the name "Performance Measurement".

As the Czech name "Měření výkonnosti" indicates, the aim of this approach is to measure performance and performance potentials of various objects in a company. Various dimension measurable ratios are used to that, such as e.g.: costs, time, quality, innovation potential, employee and customer satisfaction. Information gained by this way should allow continuous performance improvement that should positively influence also the financial results at the end.

An important aspect is improving communication processes and employee motivation. In many studies it is proven that ratios are a lot used by managers as communication means and as a tool for a decision execution. With the help of "Performance measurement", material and formal goals are defined according to demand and object groups; and strategies are executed as well as quantified and connected. The most significant signs of the "Performance measurement" can be summarized as follows:

They are a fundamental part of provided information from various groups and levels on bases of performance indicators

- They allow continuous, systematic securing and improving of performance and performance potentials.
- They improve strategic aiming.
- They orientate to interests and demands of various third parties.
- They represent a system of limited amount of financial and non-financial ratios.

2. Principal process of performance measurement system implementation

Various presumptions are necessary for a proposal and successful implementation of "Performance Measurement" in a company. Eccles (Eccles R. G., Noriah N., Berkley J. D., 1992) suggests a conception of how a principal process of performance measurement system implementation could look like:

- First we need to verify presumptions for the “Performance measurement” conception. First of all we have to establish an appropriate information structure. That contents a preparation of suitable technology and a definition of who gets what information, how and from whom.
- Probably the most important part of such a concept is modelling of performance processes and influence connections that should picture the company. From them we derive a selection, definitions and an evidence of measurable entry, process and exit ratios, which can have financial or non-financial characters. High correlation of these ratios with set objective goals has a high importance. In order to reach it, this part should be taken care of and we should thoroughly discuss performance processes and their measurable ratios with concerned places. At this phase it is necessary also to ensure moments and costs of search and execute controls of ratios importance.
- Other step includes indication of which performance report will be send to what recipient. At the same time a balance between information need and information amount is important. Frequency of different reports in which information is available should be defined in this connection. There is a close cooperation between controlling and IT department in order to find out suitable investigation, media and form of demonstrations.
- A very difficult but unavoidable step is an interlock of employee incentive system that is adapted to performance. This must declare that employee performance is evaluated by not only financial but also by non-financial ratios. Only this can highlight a seriousness of the new “Performance measurement” system.
- The last but always repeating step is a permanent consideration of its own position and verification whether the used system is adequate. This reflects the philosophy of “Performance measurement” system, which says that a company notices environment changes and is continuously adapting from performance processes point of view and also from measured ratios point of view. This is a presumption for a learning organisation.

In the last years there have been invented several of those concepts that were partially developed by scientists, consulting firms and practitioners from companies.

- Data Envelopment Analysis (DEA)¹¹
- Přístup Balanced Scorecard (BSC)¹²
- European Foundation for Quality Management (EFQM)¹³

An extensive study about usage situation and result effects is still missing. It is rather in methodological orientation phase, in which various models and processes are tested in a company. In this connection lots of information is published about experience with “Performance measurement” approach implementation and usage. Here we can critically presume positive selection and take into consideration that this selection is characterized by a high level of pragmatism.

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¹¹ DEA is normally used to evaluate manufacturers performance. A typical statistical approach is characterized as a main approach direction and evaluates manufacturers who compare themselves to average manufacturers. Controversial is the edge point of DEA method that compares each manufacturer always with the best ones. (Charnesnes-Cooper D., Rhodes J., 1993).

¹² BSC is a system of financial and non-financial ratios that should show various dimensions (customers, finance, internal processes, innovations) of a company equally one next to another. All employees and managers should be motivated by BSC system and lead into a successful realization of company strategy. (Kaplan R.S., Norton, D.P.).

¹³ Essentially EFQM model provides complex and systematic foundation for a complete evaluation of company activities, for permanent improvement and benchmarking (Mayer E., Liesmann K., Freidank C. CH., 1999).

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