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The Challenges of Corporate Performance Measurement

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Description

Corporate performance measurement has evolved in recent decades to encompass perspectives beyond historical financial information provided by accounting systems. Despite this evolution, organisations still face challenges in selecting performance measures and combining them into a performance measurement system to guide the implementation of strategy and improve corporate performance. This paper reviews the literature related to corporate performance measurement to highlight the challenges facing organisations in measuring and managing corporate performance.

Location

iC - SBS Teaching Facility

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Abstract

Corporate performance measurement has evolved in recent decades to encompass perspectives beyond historical financial information provided by accounting systems. Despite this evolution, organisations still face challenges in selecting performance measures and combining them into a performance measurement system to guide the implementation of strategy and improve corporate performance. This paper reviews the literature related to corporate performance measurement to highlight the challenges facing organisations in measuring and managing corporate performance.

Organisations face multiple challenges in trying to select individual performance measures, combine them into a performance measurement system to support the implementation of corporate strategy and keep those systems contemporary as organisations change.

Performance measurement can be defined as the process of quantifying the efficiency and effectiveness of action. Efficiency and effectiveness are defined in a customer context where; “Effectiveness refers to the extent to which customer requirements are met, while efficiency is a measure of how economically the firm’s resources are utilized when providing a given level of customer satisfaction” (Neely, Gregory & Platts 1995).

The performance measurement system operates within the internal and external environments of the organisation in which it is implemented. Internally, the performance measurement system forms part of the strategy development, goal setting, feedback and reward process of the company and is influenced by the organisational culture. The external environment consists of the customers and competitors of the organisation (Neely, Gregory & Platts 1995).

Many of the developments in performance measurement in recent decades have evolved from the conflict between operational performance measurement and financial performance measurement. McNair, Lynch and Cross(1990) suggest that information from accounting systems is not appropriate for managing operational processes as the information is too aggregated and not timely enough to support decision making at the operational level.

In response to the shortcomings in traditional financial information to support operational decisions, companies started creating new performance measurement systems as part of strategic planning or quality improvement programs and included measures such as customer satisfaction, flexibility and productivity. The intention of these control systems is to direct behaviour, evaluate performance against pre-set goals and provide information to adjust the goals over time via a feedback process (McNair, Lynch & Cross 1990).

The idea of combining financial and non-financial data into a framework of measures quickly gained momentum. Vitale, Mavrinac and Hauser (1994) suggested that balanced performance measurement systems are required to support strategic initiatives. They state "a real strategic measurement system is balanced, integrated, and designed to highlight the firm's critical input, output and process variables. Strategic measurement systems do not try to measure everything - only the elements crucial for managerial decision making."

A number of broadly based performance measurement frameworks have been proposed since the early 1990’s. The performance pyramid was developed by McNair, Lynch and Cross (1990) to integrate manufacturing and management accounting performance measures with reference to an organisation’s strategic objectives. As the name suggests the inter-relationships are represented as a pyramid with the organisations strategy at the top feeding down various levels to the most granular operational measures at the bottom. The performance pyramid is significant as it was probably the first attempt to integrate both financial and operational metrics into one performance measurement framework.

The balanced scorecard, released in 1995, was significant in raising the focus on the idea that both financial and operational measures are important in measuring performance and that performance is often improved in one area of a business at the expense of other areas. Kaplan and Norton's (2005) balanced scorecard approach proposes that in addition to the financial perspective of performance, organisations should simultaneously consider the customer, internal business and innovation and learning perspectives of the organisation. They suggested that these broad perspectives would allow an organisation to track all elements of their strategy.

The performance prism was developed by Adams and Neely(2002) who describe it as a performance measurement and management framework. One of the primary distinctions of the approach is that it applies to all stakeholders in the organisation being investors, customers, employees, suppliers, regulators and communities.

Triple bottom line reporting (Elkington 1999) could be viewed as an extension of the scope of the performance measurement frameworks discussed above. Norman and MacDonald (2004) present a review the concept of triple bottom line reporting noting that it refers to the idea that organisations should not only report on their financial performance but also on their environmental and social/ethical performance. The authors note that there is not a clear definition of the scope or intent of triple bottom line reporting. A lack of an agreed methodology for measuring the environmental and social performance hampers the comparability of performance across organisations in these dimensions.

In reviewing several performance measurement frameworks Grando and Belvedere (2008) noted that all proposed performance measurement frameworks share a common principle in selecting key performance indicators. This common principle is that the key performance indicators should be aligned to the long-term strategy of the organisation and that the framework should deploy a set of measures which align each level of the organisation to the strategy. This approach will lead to the alignment of the functional objectives and processes of the organisation with it's long term strategy.

Organisations attempting to implement performance measurement systems have found it challenging regardless of the framework or approach they have adopted. Ittner and Larker (2003) note that introducing non-financial measures should give an organisation important information on performance in advance of lagging financial information being available. A survey they conducted of 297 senior executives in 60 manufacturing and service companies found, however, most had made little attempt to identify non financial performance measures nor had they tried to establish the cause and effect links between improvements in operational measures and corresponding changes in financial measures such as cash flow, profit or stock price. Where companies did adopt non-financial measures and establish a causal link to financial outcomes the authors found the companies had higher return on equity over a five-year period. Ittner and Larker (2003) identified specific mistakes companies were making in deploying performance measurement systems. They mention not linking measures to strategy, not validating cause and effect links, not selecting the right performance targets and not measuring correctly as specific issues identified in their survey.

Norreklit, Jacobsen and Mitchell (2008) identify a number of weaknesses in the balanced scorecard approach. They claim that the balanced scorecard oversimplifies the complex nature of most organisations, that the approach does not define the relative importance of the various measures included in the framework, that the cause and effect relationships assumed in the framework may not be valid in all cases. Otley (1999) also notes that the balanced scorecard approach provides little detail on how to select specific performance measures and notes there is significant work in mapping the necessary cause and effect relationships implied in the balanced scorecard.

Kennerley and Neely (2002)propose that performance measurement system development is a static process in that a system is implemented and then organisations fail to update the systems with the changing internal and external environments. This failure of performance measurement systems to evolve means that over time they are no longer appropriate for the organisations needs.

The authors used a multiple case study approach to investigate the way performance measures actually evolve within organisations. In general, the study found that organisations recognise the need for performance measures to change over time but the evolution of performance measures was managed with varying degrees of success.

The review of the literature related to performance measurement and management highlights that there are several gaps, which warrant further research. The selection of individual performance measures whether as part of a formal framework or on a standalone basis still presents a challenge. Performance measures should be linked to the organisation’s strategy but the identification, definition, prioritisation and mix of measures within the particular organisational environment is not well understood.

Once performance measures are selected and incorporated into a performance measurement system the linkage to actual performance improvement is somewhat variable. The literature reviewed suggests that, creating cause and effect linkages between activities and outcomes, organisational culture and communication of strategic objectives as they relate to the performance measurement system are critical in the systems acceptance and actual performance improvement.

A third gap identified in the literature is how performance measures and measurement systems change as the organisational environment changes. The idea that performance measurements systems need to be agile to continue to support achievement of strategic objectives requires the triggers and processes for change to be understood.

Hence, the challenges and question facing organisations with regard to performance measurement and management include:

- How do organisations select appropriate performance measures that will have a high probability of driving improvements in organisational performance?
- What are the critical success factors in implementing selected performance measures to deliver improved organisational performance?
- How can performance measurements system remain agile in a changing organisational environment?

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