Performance measurement and evaluation

SUMMARY

Financial performance measures provide quantitative and common yardsticks to evaluate achievement relative to a plan or to compare parts of the company. In that these reflect or are taken to reflect the achievement of the individual divisional manager, we can see that financial performance measures contribute to results controls, in particular.

The conventional use of profit performance measures is open to criticism in the multidivisional company. Quite apart from the variety of definitions of profit, all such measures can exhibit defects of incompleteness, inaccuracy and non-neutrality. Technical sophistications like residual income and divisional costs of capital offer some advantages but cannot in themselves ensure behaviour congruence. A wider perspective is required to examine performance measurement and evaluation in the organizational context. This recognition leads to the development of a contingency framework which includes financial performance measures and the importance of linked incentives and also personnel and monitoring devices and the style of evaluation.

INTRODUCTION

This chapter is divided into three sections. The first section outlines the conventional contribution that an AIS makes to management control. The measurement of the performance of the divisional management in practice is reviewed, and the connections between incentive schemes and accounting performance measures are examined, particularly the fundamental assumption that performance can be accurately measured by means of accounting information.
The contribution of the AIS to management control

The second section, the potential defects of accounting measures of performance, namely that they are incomplete, inaccurate and non-neutral, are analysed. The repercussions of using the conventional AIS in the multidivisional company are outlined and some alternatives put forward. The third section presents alternative forms of performance measures, monitoring devices and styles of evaluation that are more appropriate to the aim of promoting behaviour congruence, and a contingency framework for performance evaluation is developed.

THE CONTRIBUTION OF THE AIS TO MANAGEMENT CONTROL

The conventional review of the contribution of the AIS to management control in divisionalized firms assumes (Gordon, 1964; Thomas, 1980b) that:

1. Divisional managers desire certain rewards that top management can give – e.g., esteem, increased perquisites, bonuses and promotion.
2. Divisional managers are led to understand that receipt of these rewards will be positively correlated with the performance of their divisions.
3. Divisional managers are left to maximize their self-interest by attaining or surpassing the performance measures set by top management.

Of fundamental importance in upholding this view is the assumption that accounting performance measures accurately reflect the decision-making capabilities of the divisional manager. A comparison of expected and actual performance highlights deviations from plans, and, with recourse to a predictive model, ways to avoid future deviations can be suggested. The accurate measurement of actual performance is important if this form of feedback control is to be effective. This form of management control assumes that accounting performance measures can help detect inefficiencies, and requires managers to be held accountable for them. Hence top management’s use of accounting information for feedback control may reduce the incentives for opportunistic behaviour by divisional managers. The divisional managers’ commitment to the targeted performance is motivated by the clear connection between ‘good’ performance and various desired rewards. It is therefore important to understand how such systems are used in practice, and we now turn to the empirical evidence to gauge the use made of the AIS in performance evaluation.