An Accounting and Finance Perspective on Performance Measurement and Management

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Introduction

Managers measure organizational performance in order to improve it; thus performance measurement is part of the process by which management teams manage the improvement of performance over time. Management is a team activity involving people with different functional responsibilities and disciplinary backgrounds, yet traditionally most measures of organizational performance have been financial in nature. More recently it has been widely recognized that what constitutes organizational success is multifaceted and means different things to different people. Accordingly, models of multidimensional performance measurement and management have been developed which have fostered an interest in the interrelationships among different performance dimensions, including those between financial and non-financial performance measures.

In what follows we shall first consider in more detail the conventional view of accounting and finance performance measures. Three main functions of such performance measures are then identified and considered in turn: financial performance as a business objective; financial performance measurement as a tool of financial management; and finally as a means of motivation and control. In the next section we examine the criticisms of mainstream financial performance measurement and consider how new financial performance metrics aim to overcome them. Yet these new metrics are only a partial answer to these criticisms so in the penultimate section of the chapter we consider some of the models of multidimensional performance measurement that have led to new directions in strategic performance management, such as Kaplan and Norton’s ‘strategy mapping’ concept. In the final section of the chapter...
we consider the current problems and challenges for research in these areas.

**The conventional view of the accounting and finance role**

Traditionally, organizational performance management has focused on the use of quantitative financial measures of primary interest to shareholders. In most writings on accounting and finance it is usually assumed that managers of for-profit organizations should be trying to maximize their shareholders’ wealth. The extent to which this actually happens and the conditions for ensuring it does so are the subject of Agency Theory (Jensen and Meckling, 1976). Jensen and Meckling argue that asymmetries of information among owners and managers cause control problems which can be tackled by the use of incentives such as share options to encourage managers to align their goals with those of shareholders. In this context, accounting information such as that in the annual report and accounts enables shareholders to monitor the performance of managers to see if they are acting in shareholders’ interests. In a similar fashion, managers use management accounting systems to control the actions of subordinates in the process of management control.

One of the strengths of financial performance measures is that accounting uses a common measure of wealth: money. But the use of a common measure still leads to two different yet complementary approaches to measuring stocks and flows of money: cash versus accruals accounting. Under cash accounting, money received and paid by a business entity in a period is recorded; if cash received exceeds cash paid out, the cash balance will increase. Under the accruals approach income earned from sales made in a period (but not necessarily received in the period) is matched against expenses incurred (but not necessarily paid) in the same period: if income exceeds expenses a profit is recorded for the period. In practice an organization’s books and accounts record its transactions in a double entry book-keeping system culminating in the usual periodic financial statements: the profit and loss account, the cash flow statement and the balance sheet. Of the three, the balance sheet is prime as the cash balance at the end of the accounting period and the profit earned in the period are inserted into the balance sheet to enable it to ‘balance’ the entity’s liabilities against its assets.

The use of ratio analysis of an organization’s financial statements to interpret its performance was arguably pioneered by the Du Pont Company. In for-profit organizations, the ultimate focus is on an organization’s return on investment (ROI), which can be expressed as a