

## NON-FINANCIAL PERFORMANCE CONTROL - THE KEY TO A SUCCESSFUL BUSINESS

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### Abstract

The financial performance control is a key to success for any company. The performance indicators are the efficiency expression of any company actions, so, undoubtedly, financial performance measurement is the most important in taking a business pulse. But professor R.S. Kaplan in his paper *The Evolution of Management Accounting* notes that: "[...] if senior managers place too much emphasis on managing by the financial numbers, the organisation's long term viability becomes threatened." Expanding the information provided by managerial accounting with non-financial data will become a real support for the long-term strategies of the companies.

Therefore, in this article we will highlight the importance of information provided by non-financial indicators and we will look for the advantages and disadvantages of their use in management accounting.

**Key words:** non-financial indicators, non-financial performance, Balanced Scorecard

Accountancy is conceived as an information system which allows producing and spreading information in order to make decisions (Ionașcu, 2003). As a consequence, estimating and communicating financial results is an essential part in accountancy. But, we can state, based on the arguments presented by professor Kaplan (Kaplan, 1983), that the financial systems of performance measurement are insufficient to evaluate and promote the improvements regarding the competitiveness or efficiency of the new methods of management accountancy.

The declaration of the International Federation of Accountants (IFAC, 1998) shows the development of management accountancy in gradual stages. Thus, the first stage (before 1950) is characterized by the interest in fixing the costs and in financial control, when applying techniques of elaborating budgets and complete cost management. During the second stage (until 1965) the attention is concentrated on producing the necessary information to management planning and audit, using techniques such as decision analysis and responsibility accounting. During the third stage (until 1985) the focus moves onto the reduction of resource waste in the activity of the companies, with the help of process analysis and cost management techniques. After 1995, the interest is to produce value by an efficient use of resources, with techniques which allow the analysis of value inductors for the client or for the shareholder by means of organisational innovation.

During the 1st and 2nd stage, the company performance, especially production performance was reported in the financial results. In other words, in the greatest part of the 20th century, the breach of the standard cost was the main indicator of monitoring of production activity. The non-financial indicators were not integrated, at that time, into financial control systems. But, starting with the third stage, the measurement of real processes performance started to be integrated into monitoring systems.

The changes in the business environment and of the technologies used by the companies in their daily activity could produce essential changes at the level of management accountancy. Thus, these changes lead to new decisions and to new problems related to management control (Bruggeman, Slagmulder, 1995). As the companies are trying to adapt to these new evolvments, they should ensure that their management accountancy systems are keeping the pace with the requirements of the new management control (Chenhall, 2003).

The traditional accountancy methods of performance measurement (for example, product costs, work productivity, material variances or labour force variation and their return) offer a little information regarding certain aspects of the activity of the whole society such as quality or the involvement level of the employees, the timing of production, delivery and client satisfaction (Fullerton, McWatters, 2002). This contributed to the development and popularity of non-financial performance measurement methods.

The surveys undertaken by the greatest producers in Great Britain (CIMA, 1993) highlighted the revealing of non-financial indicators, laying stress on the problems related to quality and marketing activities. The aspects related to non-financial performance, such as client satisfaction, employees' efficiency and the level of quality were also considered to be important by all the respondent companies for CIMA (1993).

## MATERIAL AND METHOD

While conducting our research in order to identify the methods used by the companies to measure performance and to establish the advantages and disadvantages of using non-financial indicators, we have stopped over an aspect which needs to be deepened, in our view, namely the need to measure performance by means of non-financial indicators.

The development of multinational companies and the conglomerate business activities from the beginning of the 20th century lead to the need to measure the performance, not only of the company as a whole, but of every division. As an answer to this need, there was conceived a set of indicators (ROI - Return on investment, ROA - Return on asset, ROE - Return on equity) which have turned to be, since 1960, the most relevant indicators for the estimation of organizational future performance.

In time, many European companies, but especially American companies lost their competitiveness in favour of the Japanese companies because they were guided mostly by the information offered by these financial indicators, inadequate for the measurement of performance in a new economic environment (Johnson, Kaplan, 1987) based on knowledge and innovation.

The non-financial indicators have attained a major importance when the work entitled "Balanced Scorecard" by Kaplan and Norton was published in 1992. Nevertheless, the literature in the field shows that in the domain of human resources the use of non-financial performance indicators, in great part with reference to the 'employees' morale', such as turnover on each employee, absenteeism and tardiness have been used for a long period of time (since 1920). Chenhall (2006) considers that the control methods and non-financial performance measurement methods are more and more adopted by the Just in Time (JIT) and Total Quality Management (TQM) environments.

The non-financial indicators rank in a wide and varied range, covering the whole operation environment, such as:

### 1. Objective non-financial indicators

#### 1.1. *Indicators oriented to organisational activities*

- Production volume
- Work productivity

- Equipment productivity
- Degree of material usage
- Efficiency of inner organization
- Duration of production cycle
- Stock level
- Number of flawed products
- Number of newly launched products
- Efficiency of new product design

#### 1.2. *Indicators oriented to the employees*

- Satisfaction of the employees
- Level of employees' skills
- Degree of employees' empowerment
- Level of safety measures
- Level of the employees training
- Turnover on every employer
- Degree of absenteeism

#### 1.3. *Indicators oriented to the client*

- Market share
- Time necessary to fill the client orders
- Delivery performance
- Time to answer to the problems of the clients
- Product flexibility
- Client satisfaction
- Degree of client attraction
- Degree of client retention

### 2. *Subjective non-financial indicators*

- Long-term perspective of the business
- The ability to gain new skills / knowledge in an efficient way
- The will to share knowledge in the organisation
- Degree of cooperation with the other departments in the organization
- State of mind/morale of the employees in the department
- Management / leadership style
- Degree of loyalty to the company

During the last 10-15 years, the cost management methods have been revolutionized. In order to keep up the pace with the new technology and the evolution of the information society, the accountants, the university teachers and the researchers worked together to bring innovation in the field and to give a new shape for management accountancy. Intrigued but motivated at the same time by the criticism brought to the accountancy system by Kaplan and Johnson in *Relevance Lost: The Rise and Fall of Management Accounting*, during the last years they elaborated a new series of instruments which are easily available for the managers who are not also accountants, instruments which are more efficient and offer more relevant information in the decision-making process.

Therefore, starting from activity based costing (ABC) going to activity based management (ABM), the innovations introduced in the system of cost management are the following: value management with the help of other indicators such as economic value added (EVA) and market value

added (MVA); measuring performance with the help of non-financial indicators and using as instruments the dashboard or the Balanced Scorecard; the strategic cost management; creating links between cost management and the other performance indicators in integrated systems of performance management; a more evolved administration control, adapted to the requests of information society.

We shall focus only on the use of the dashboard and the balance scorecard.

The „*tableaux de bord*” was developed in the French factories, including non-financial indicators regarded by the managers as critical for success which were rather developed and monitored at the level of the company as part of the formal report process.

The methodology of elaborating the dashboard is rigorous and requires, firstly, conceiving a project which evaluates the organisational context and its usefulness at the level of that particular responsibility center.

Some indicators used in the dashboard are of non-financial nature, a fact which allows a quicker decision of the decision makers to the unexpected or important changes in the business environment. The dashboard enables a better relationship between the operational administration which demands quantities and administrative management on the entire level of the organisation which requires values.

The basis of *Balanced Scorecard* were laid by professors Robert Kaplan (Harvard Business School) and David Norton and it later became an instrument used on international level as an alternative to the practice of reporting used by the American companies, based only on financial indicators. BSC was conceived as a method of measurement of strategic performance, bringing together the traditional indicators to measure financial performance with non-financial indicators in order to make the managers have a more real vision on the organisational performance. The Balanced Scorecard does not offer only information about the performance indicators, but it also helps the managers identify what should be done and measured.

Kaplan and Norton keep in the Balanced Scorecard a series of financial indicators, but they mention:

"The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate story for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value [...]" (Kaplan and Norton, 1996).

In their attempt to control and maximize the financial performance of the company, the managers settle only short-term objectives, but a

company which aims to become more and more competitive and eventually to increase its market share, needs long-term strategies and their success cannot be quantified in real terms only with the help of financial indicators of performance. Consequently, we can assert that the non-financial indicators offer certain clear advantages in comparison to the control systems based on financial data.

The method used to identify the advantages and disadvantages in the use of non-financial indicators for the performance measurement and the non-financial performance estimation is the analysis of yearly reports of international companies quoted on the market, coming from different industries, so as to identify the ones which use such indicators. It is also necessary to analyse the surveys undertaken in Great Britain and in other countries on this topic in order to determine the importance given by the CEO to the use of these indicators, the analysis of some dashboards and balanced scorecards to outline the most frequently used groups of indicators.

## RESULTS AND DISCUSSIONS

One of the advantages of using non-financial indicators is the tight relationship with the long-term organisational strategies. The financial systems of performance evaluation generally concentrate on the yearly performance, namely on short-term performance. They do not refer to progresses in relationship to the client or competition demands, they do not refer to the non-financial objectives which might be important for profitability, competitive power or other long-term strategic objectives. For example, the development of new products or the enhancement of managerial abilities could be important strategic objectives, but they could cause decreases in short-term performance. Adding non-financial data to the accountancy reports regarding strategic performance and applying strategic plans could encourage the managers to approach long-term strategies.

The critics of traditional indicators of performance measurement claim that the success factors in many fields are "intangible", such as the intellectual capital and the techniques of client loyalty increasing. Although they are difficult to quantify from the financial point of view, the non-corporative assets could reveal indirect quantitative indicators by means of non-financial data. Recent studies have found that the indicators related to innovation, management ability, relationships between the employees, brand quality and value explained the significant increase of the company value with a market share. Leaving out these non-financial indicators but at the same time financially

oriented, the managers could be sometimes encouraged to take measures against the benefit of the company.

Thirdly, the non-financial indicators could estimate even better the future financial performance. Even when the final purpose is attaining a maximum financial performance, the financial indicators cannot quantify on long-term the benefits of the decisions made in the present. Let us consider, for example, the investments in research and development or the client satisfaction programmes. According to the accountancy regulations, the research and development expenses should be included in the period they are made, thus reducing the profit. Nonetheless, the results of the research will bring future profit only in the case they can be introduced on the market. Similarly, the investments made for the client satisfaction could improve the economic performance later on, due to an increase in incomes and client loyalty, by attracting new clients and reducing the expenses related to client litigations. The non-financial data could make a link between accountancy and future benefits of certain investments supplying prospective information. For example, the intermediary results of research or clues related to the client activity could offer information regarding the future cash-flow, an information which could not have been found using financial estimates.

Starting from the hypothesis that any increase in non-financial performance should correspond to an increase in the company incomes, we could assert that an analysis of the financial and non-financial factors could help the auditors in their evaluation of fraud risk.

Even though there are many advantages of measuring performance with the help of non-financial indicators, our research identified a series of disadvantages at the same time. One of them is that the identification and creation of a set of adequate non-financial indicators sometimes entails much higher costs than the benefits a company could obtain by using those indicators. This disadvantage is usually registered by the relatively small companies, with homogenous activity and the costs usually require an adaptation of the information systems and data base to the new requirements. The development of such a set of indicators could last a long time and the employees are accustomed to the old procedures and they are skeptical about the improvement of their status.

Evaluating performance using multiple short-term indicators which could be in conflict might be also considered a disadvantage as it wastes time. For example, a manager who will

evaluate performance only using financial indicators will need a longer time if he is to use a series of non-financial indicators as well. These situations are most frequently met in the case of financial institutions (banks). Another example could be the case of Romanian companies, where bureaucracy could degenerate, thus prolonging the duration of the performance estimation process using non-financial indicators. This is due to the fact that the non-financial data, opposed to the accountancy data, could be measured in several ways and there is no standard procedure. The estimation of total performance is difficult when a series of indicators is expressed in units of time, percentages and other indicators are expressed in quantities or other arbitrary means.

The lack of causal relationships is another issue faced by the companies which use non-financial indicators. These companies do not check whether the non-financial performance has any influence on the accountancy data or if the non-financial indicators are related to the financial ones. Disregarding these relations could lead to difficulties in attaining a correct performance estimation. Thus, any incorrectly estimated indicator focusses on wrong objectives and the expected benefits no longer appear in a quantified form. To give an example, we could consider the case of a company detaining the monopoly on a certain market. An estimation of client satisfaction or loyalty would be useless because the performance of the company does not depend on these indicators, the clients being forced to make use of the existing services.

Another disadvantage of the non-financial indicators is the lack of statistic reliability. The non-financial data is usually based on statistic surveys mostly accomplished with a small number of questions and a few respondents.

The current role of management accountancy is to integrate different sources of information and explain the connections between the non-financial performance indicators and the information detained by accountancy (Burns, 2003). This would allow the managers to make the link between organisational daily activities, the way in which they are presented in management accountancy and how they interact with the strategies shown by the non-financial indicators.

The non-financial performance indicators could be used by administrative accountancy for a better understanding of operational activities so as to plan the control systems. Another advantage of using these indicators in management accountancy could come from the possibility to connect the control systems with the business strategy, an idea

which is in part approached by *Strategic Management Accounting*.

The most important barriers in the use of non-financial indicators in management accountancy proved to be the lack of time, lack of the necessary technology, the difficulties in gathering data, but also the fact that a company has many other priorities.

## CONCLUSIONS

Although there are strong arguments for the use of non-financial indicators for organisational performance measurement, there are not enough arguments to leave aside the traditional financial indicators. The only certainty is that financial indicators "look towards the past" and they help the managers to identify the cause of the problems, while the non-financial indicators are present and "look towards the future", thus allowing a quicker reaction of the decision-makers should unexpected or important changes appear in the business environment.

The studies reveal the fact that many companies, in different fields of activity, use combinations of financial and non-financial indicators in order to monitor their present and future performance. Nevertheless, choosing, planning and implementing such a set of indicators should be carefully done lest the companies should not end up in measuring everything. (Kaplan, Atkinson, 1998).

In Romania, the paradigm of administrative audit dominates management accountancy, while the use of non-financial indicators for performance measurement is isolated from the accountancy domain. In spite of the fact that international accountancy practice advises their use, many of Romanian companies remain faithful to the financial quantification of performance.

In an information era when competitiveness is based on information management, non-financial performance measurement and control is vital in order to determine organisational success and value.

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