GOOD GOVERNANCE, ACCOUNTABILITY & INCLUSIVENESS AS PANACEA FOR ECONOMIC MANAGEMENT IN NIGERIA

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COMPREHENSIVE PERFORMANCE MEASUREMENT SYSTEMS: TOOLS FOR EFFECTIVE ECONOMIC MANAGEMENT

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Abstract

Performance measurement is all-endearing given its various roles identified in literatures. In spite of its shortcomings accounting performance measures have been traditionally and largely used by organisations to manage strategies to the advantage of stakeholders.. On this note, this paper critically evaluates accounting-based performance measures purposely to give insight on the need to embrace comprehensive performance measures as contemporary measurement tools for effective economic management. This is achieved through conceptual clarification of performance and performance measurement; evaluation of accounting-based performance measurement using Merchant and Van der Stede (2007) evaluation criteria; detailed discourse on various comprehensive performance measurement models that have evolved over the past two decades, with emphasis on their strengths and weakness; and, concluding remarks with advise that CIMA's suggested steps to develop an effective performance measurements be followed to derive maximum benefit from any chosen performance measurement model.

1. Introduction

Organisational success is usually described through the word "performance". This makes the issue of performance measurement a multi-disciplinary field of engagement. Experts in the field of operation management, marketing, finance, economics, and psychology in one way or the other, partake in the development of various strategies. This is in terms of providing theoretical and practical knowledge required of organisations to monitor performance at both individual and organisational levels. In the field of operation management for example, measures are developed to gauge efficiency and effectiveness of business, while in the field of marketing, much emphasis is

placed on ensuring the final outcome of marketing efforts in terms of customer satisfaction and effective competitive advantages which are measurable as information for planning and control (Neely, 2004). Other disciplines including those earlier mentioned, engage in this line of practice mainly to maximise shareholder value (Merchant and Van der Stede, 2007).

Indeed, performance measurement is all-endearing given its various role identified in literatures. Bento and Bento (2006) see performance measurement as enabling means for organisations to plan, measure, and control their performance through which decisions, resources, and activities can be better aligned with strategies to achieve desired results. Similarly, Australian Public services (2001) ascribe the provision of means of recognising and rewarding good performance and managing poor performance both at individual, division, and organisational levels as the main role of performance management or measurement practice. Brunnetto and Fair-Wharton (2005) and Hood (1991) affirm that performance measurement practices assist organisations to avoid conflict and ambiguity in the pursuit of main objectives of firms.

Although other disciplines with interest in performance measurement provide various metrics focusing on different areas of operation, accounting performance measures have been traditionally and largely used by organisations to manage strategies to the advantages of stakeholders. Murphy (1999) in his study of executive compensation, revealed that at least one accounting measure are found to be included in annual bonus plan of 161 firms out of 177 sampled firms. However, reliance on accounting-based measures has severe short-comings. These range from imperfect surrogate for economic income, facilitating shortermism, the encouragement of data manipulation such as gaming and slack building.

In response to these criticisms, a great deal of attention has been devoted to the development of comprehensive performance measurement. This contemporary strive consists of both financial (accounting-based) and non-financial measures to facilitate effective economic management. It is on this that this paper critically evaluates accounting-based performance measures purposely to give insight on the need to embrace comprehensive performance measures as contemporary measurement tools for effective economic management.

The subsequent part of this paper is structured as follows: section two gives brief conceptual clarification of performance and performance measurement. Section three evaluates accounting-based performance measurement using Merchant and Van der Stede (2007) evaluation criteria. Section four provides a discourse on various comprehensive performance measurement models that have evolved over the past two decades with emphasis on their strengths and weaknesses. Section five provides concluding remarks with advice that CIMA's suggested steps to develop effective performance measurements should be followed to derive maximum benefit of any chosen performance measurement model.

2. Conceptual Clarification of Performance and Performance Measurement

Consensus on the meaning of performance is not available as scholars like Cameron (1986) affirm the absence of agreed clarification of the concept. This has led to different perceptions and interpretation. A leeway to conceptually clarifying the concept of performance is to define it from the perspective of various activities carry out in any organisation and the resources use in the process to achieve set of objectives. The ability of any organisation to achieve its objective through various activities embarked upon and using reasonable resources is usually the basis of judging how well an organisation is performing. In fairly precise term, performance can be described as the nature and quality of activities carried out using reasonable resources to achieve the objectives of an organisation or entity. Primarily, the objective of a profit-oriented organisation is shareholders' value maximisation and by extension stakeholders' value (SinK, 1991). By interpretation, a good performance measurement practice must identify that a relationship exists among activities/process, resources, and output (objective).Therefore, performance measurement is the process of determining how effective are the activities put in place in the realisation of an organisation's objectives and how efficient the process is in the utilisation of resources in carrying out those activities. These ideas, to a great extent, align with the description of performance measurement offered by the Chartered Institute of Management Accounting (CIMA) in its official terminology of 2005 that it is :

> *the process of assessing the proficiency with which a reporting entity succeeds, by the economic acquisition of resources and their efficient and effective deployment, in achieving its objectives. Performance measures may be based on non-financial as well as on financial information.*

Interoperability Clearinghouse Glossary of Terms, 2005 equally states that performance measurement is:

> *the process of developing measurable indicators that can be systematically tracked to assess progress made in achieving predetermined goals and using such indicators to assess progress in achieving these goals.*

These two definitions emphasise the main aim of any performance measurement practice to be the attainment of predetermined objectives or goals. They also stress models of pursuing the practice which are beyond accounting measures. More importantly, the definitions indicate that the practice of performance measurement entails the development of parameters to assess or track the extent to which objectives are achieved. These parameters are expressed differently in different literatures but they reflect similar ideas. Some designate the parameter as performance measures, others call it performance metrics, while others refer to it as Key Performance Indicators (KPI). However, performance indicators are more commonly used. Eckerson (2006) describes KPI as a metric that embeds performance targets so that an organisation or entity can track its progress towards set goals. Performance indicators measure the vital activities and processes that reflect the health of an

organisation, contrary to plain measures that measure non-critical activities and processes. Furthermore, they align all levels of an organisation and ensure that all individuals are 'marching' towards the same goals. Thus, performance indicators are more than plain measures; they are measures that incorporate a context. This context is given by strategy and objectives, as well as by targets.

Scholars have identified various ways in which performance indicators can be classified. For instance, Fitzgerald *et al.,* as mentioned in Nelly, Gregory and Platts (1995) classified performance indicators into: lagging and leading indicators. Accordingly, lagging indicator are those that relate to results while leading indicators are those focusing on determinants. Leading indicators measure activities and processes that have significant effect on the future performance of the organisation. They measure the so-called key drivers of the organisation. Leading indicators provide an early indication about whether the strategy is being implemented successfully. They are either based on the current state, or on a future planned state. Quality level, employee morale, and on-time deliveries are typical examples. The consensus is that focusing on leading indicators will have a significant impact on lagging indicators. Fitzgerald *et al.*, as reported in Neely *et al.*,(1995) equally argued that increasing quality level and high employee morale are often followed by higher customer satisfaction and consequently, an improvement of financial results. Lagging indicators, on the other hand, measure the results of past activities and processes of the organisation such as its past performance. Typical examples of lagging indicators are traditional financial measures such as revenue, costs, and profits, and non-financial indicators such as market share.

Keegant *et al.,* cited in Neely et al., (1995) make a distinction in their performance measurement matrix between indicators that measure internal aspects, and those that measure external aspects of the organisation. Internal indicators are typically related to processes, costs, and revenues, and may include measures such as number of new products, manufacturing costs, productivity, and cycle times. External indicators usually relate to markets, customers and shareholders and may include measures such as market share and customer satisfaction. Kaplan and Norton (1992) on their part advocate the use of both financial and non-financial measures. Financial indicators include traditional measures such as profit, return on investment, and price variances. Typical non-financial indicators include quality level, customer satisfaction, on-time deliveries, and employee morale.

With these classifications, one may infer that a good performance measurement practice should reflect the ability to provide information that can assist managers in all activities germane to the attainment of an organisation's objectives. This requirement makes accounting or traditional measurements to have limited capacity in providing adequate and relevant feed-forward and feedback information necessary to survive in the contemporary business environment. In view of the foregoing, it will be of relevance to evaluate the strengths and weaknesses of the accounting-based

performance measures and comprehensive performance measures using the criteria of congruence, controllability, precision, objectivity, understandability, and cost efficiency.

3. Accounting-based Performance Measures: Its Strengths and Weaknesses

Accounting-based measures can be viewed to consist of residuals terms such as net income after tax, operating profit, residual income or economic value added or expressed in ratio such as return on investment, return on equity or return on assets. They are all refer to financial measures of performance because of being usually denominated in a currency such Naira (Merchant and Van der stede, 2007). The measures are products of various financial reporting standards. Accounting-based measures are used in practices as result-control techniques capable of playing valuable roles of motivation and decision making. Hall (2011) is of the opinion that psychological theories affirm the efficacy of performance measures in influencing individual performance through cognitive and motivational mechanisms. It can be described as a strategy of achieving the main objective of a firm-shareholders' value maximisation. This is made possible through the indirect measurement of individual employees' contribution to the value creation of the firm.

(Merchant *et al.,* 2007) ascribe the criteria of timeliness, precision, and objectivity as strengths of accounting-based measures. They argue that accounting profits are usually measured within short periods of time in a precise and objective manner. This, in effect, goes a long way to encourage a manager to exert more effort in the pursuit of the organisation's objectives. Being objective measures, individuals respond in a better way to feedback than when there is no clear-cut or vague statement such as "do your best". The incentive based on objective accounting measures also reduces the argument that may emanate from measurement method. Thanos and Papadakis (2011) also affirm that accounting-based measures are less influenced by potential bias.

Since the main objective of an organisation is profit maximisation, accounting measures effectively reflect this goal and thus can be said to be relatively congruent with firm value maximisation. For instance, Lev (1989) empirically establishes positive correlation between accounting profit and changes in stock prices. This evidence shows that individual managers are actually pursuing their individual goals as well as firm aspiration of increase in values measured through stock performance. In terms of controllability, accounting measures can be said to be within the authority of managers whose activities are being monitored. The effort expend by managers is relatively reflected in the form of positive operating profit that form the basis of various accounting measures. Indeed, Sloan (1993) is of the opinion that accounting profits are not as severely affected by some uncontrollable factors (such as interest rates) as market prices.

Apart from the foregoing, accounting measures are inexpensive and understandable. Since, it is statutorily required for firms to measure and report financial results to outside users, particularly shareholders and creditors, the same data is used as basis of computing various performance

indicators at little or no cost. It is familiar measures that have been in use for so long and of course, the principles upon which the measures are derived are being taught in standard accounting courses in schools (Merchant *et al.*, 2007).

Finally, Drury (2012) advances some reasons why accounting measures are predominant control measures in practice. These reasons include: the need of organisations to express and aggregate the results of a wide range of dissimilar activities using a common measure are usually met by accounting measures; the manager's natural willingness to monitor performance in monetary measures are also the focus accounting measures; accounting measures considerably give managers a sense of autonomy; it also allows managers to use common decision rule when considering alternative courses of action; and finally, outcome or output expressed in financial terms continue to be effective in uncertain environments. However, Merchant et al., (2007) is of the view that accounting measures of performance are not perfect reflections of firm value changes. In other words, accounting measures do not perfectly reflect economic income because of the following reasons:

First, accounting profits are products of accounting systems that are transaction-oriented and which do not reflect most changes in values that are not products of transaction. Accounting measures are also highly dependent on choice of measurement method. Identical economic events can be measured using different accounting approach. Of particular example is a different method of depreciation options. The conservative principle applied in recognition of revenue and expenses for computation of accounting profit measures is also responsible for less perfect measurement of economic value of the firm as revenues are not well matched with expenses. This thus makes the accounting measures to be conservatively biased. Less recognition accorded to intangible assets, such as human resources, information systems and customer goodwill, in the computation of accounting profit measures makes it less perfect reflection of economic value of firms especially in this era information age.

Second, accounting profit measures also fail to reflect the cost of investment in working capital where there is bad investment in extra inventory, as well as cost of equity capital leading to over statement of profit. This is based on the argument that real income is only earned when the returns on capital are greater than the cost of capital. The general thesis that economic value derives from future cash flows is lacking in the computation of accounting profit measures since it is based on past events or transactions.

Given the foregoing weaknesses, it is essential for managers with keen interest in effective economic management of an entity to know that reliance solely on accounting measures of performance as a control technique can create a number of dysfunctional behaviour. Indeed, accounting performance measures are often accused of stifling innovation and learning (e.g. Bartlett & Ghoshal, 1993;

Emmanuel, Otley, & Merchant, 1990; Hope & Fraser, 2003), encourage or induce data manipulation, interdepartmental strife, job-related tension, group based 'anti-management 'behavior, 'gaming' and short-termism (Marginson & Ogden, 2005).

4. Comprehensive Performance Measures:

Numerous among the shortcomings of accounting measure of performance are often addressed by well thought out combination of measures or comprehensive measures (Merchant, 2006). This is achieved by combining more future-oriented measures with accounting measures to attain a balanced performance measurement system. Non-financial measures are future-oriented measures which can provide advanced information about what the future holds. They are the leading indicators of future performance. These measures are usually expressed in the areas such as market shares, research and development, product quality, customer satisfaction and many more that may indicate the accomplishment of organisational goals.

Integrating accounting measures with other non-financial measures discourages managers from pursuing short-term profit maximisation strategies at the expense of firms' future prospects. Non-financial measure components of comprehensive performance system are a set of value drivers with capacity to focus on present scenario that may translate to increase in firms' future value. Comprehensive performance measures essentially contain leading indicators; reflect economic effect on shareholder value of specific management accomplishment and failure more quickly than only accounting measures (Merchant et *al.*, 2007). In effect, it encourages managers to be more conscious of drivers of future profit. Multi-dimensional approach to performance measurement may also provide complete reflection of performance since it captures areas of performance that are not reflected in summary accounting measures. Consequently, all aspects of an organisation's process which are germane to its success are well reflected to managers, thus minimising manager's tendency of sub-optimisation and facilitating goal congruence.

The interest of all stakeholders can be said to be adequately catered for through the use of comprehensive system of performance measures since both lagging and leading indicators as elements of this approach cover all aspects of an organisation's existence. Specifically, the interests of employees, customers, suppliers, environmentalist, government, and society at large are in one way or the other, expressed as metrics to measure performance completely. In addition, comprehensive performance measures may assist managers with clear direction rather than single accounting measures, thus enhancing understandability. Reliance solely on accounting measures may not give clear picture of what firm expects of a manager. More importantly, comprehensive measures are indefinitely flexible since managers can integrate more measures to reduce or minimise any weakness observed in existing performance measurement system.

Although, comprehensive performance measures portend substantial benefit than single accounting measures, essential factors or issues such as:

a) maintenance of fit between organisation characteristics and choice of measures included in a performance measurement system must be critically evaluated;
b) decision on how to measure each indicator in a system and numbers of measures to be included must be adequately scrutinised; and,
c) also very important to consider is the size of weight attach to each measure in the system.

4.1 Models of Comprehensive Performance Measures

The indefinite flexibility earlier mentioned as a feature of comprehensive performance measurement system has encouraged the development of a variety of models of performance measurement. Prominent among these models are: Balanced Scorecard, Performance Measurement Matrix, Performance Pyramid System, Performance Prism and European Foundation for Quality Management (EFQM). Striteska and Spickova (2012) affirm that the mentioned performance measurement models are more common and more cited approaches to performance measurement. However, each model has its benefits and limitations briefly discussed as follow:

Balanced Scorecard (BSC): This model was developed by Kaplan and Norton (1992, 1996). It is used to describe, implement and manage strategies at all levels in the organisation. Schwartz (2005) argues that BSC provides three basic functions of measurement system, system of strategic management, and the tool for communication. In specific term, BSC is premised on the logic of aligning an organisation's vision and strategy into measurable fixed targets and intelligible sets of financial and non-financial performance indicators. It aims to provide management with balanced measures based on four perspectives: the financial, the customer, the internal processes, and the learning and growth (Garengo, Biazzo and Bititci, 2005). Striteska (2010) explains the logic of the word "balance" in the model to mean equability between the short-term and long-term goals; required input and output; internal and external performance indicators; and financial and non-financial indicators.

The first of the four perspectives of BSC (financial perspective) measures an organisation's ability to make profits. This is usually expressed in the form of performance ration of Return on Investment (ROI), Return on Assets (ROA), Return on Equity (ROI) and also in absolute time of cash flow and profit. The second perspective, Customer Perspective, which is evaluated and measured through metrics such as company image, market share, customer retention, and product quality, measures how customers see the organisation (Drury, 2012). The third perspective is the internal process which focuses on what business process an organisation must put in place to excel in effectively satisfying customers and shareholders. This perspective consists of lead measures that are linked to the organisational business process. The process spans through product development to the sales/services rendered to customers (Garengo *et al.,* 2005). Learning and growth perspective, the fourth perspective, addresses how organisations can continue to improve and create value through the use

of continuous learning strategies. The four perspectives offer a transparent picture of interconnection between the organisation's success and drivers of performance (Striteska *et al.*, 2012).

BSC, according to Striteska *et al.*, (2012), has the capacity to assist organisations with clarity of vision and strategy to be adopted to achieve the vision. It also facilitates consistent monitoring of strategy, provides basis of concentrating on strategic critical business objective, and, it serves as instrument to management in the identification of cause and relationship among critical success factors. Notwithstanding these strengths, BSC fails to express all the interests of stakeholders. It is also constructed as a control tool rather than an improvement tool. More often, metrics constructed based on BSC are unattainable.

Performance Measurement Matrix: Keegan, Eiler and Jone (1989) introduced this model of measurement to help companies translate strategic objectives into measures of performance through an integrated approach. It integrates different dimensions of performance in a two-by-two matrix combining cost and non-cost perspectives with internal and external perspectives (Garenco et al., 2005; Striteska, 2012). Neely, Adams and Kennerley (2002) see this integrative approach as the strength of this model. It has also been described as simple and flexible. However, Neely, Mills, Gregory and Richard (2000) criticise the model for not including some perspectives that are explicitly included in other model like BSC.

In response to this shortcoming, Fitzgerald, Johnson, Brignall, Silverstro and Voss (1991) developed a modified system of performance measurement matrix labelled: result and determinant. As remedy to the identified shortcoming, they ensure that the modified model provides a link between different dimensions of business performance. The Modified performance measurement matrix is premised on the assumption that in any organisation, there exist two basic types of performance measures: those that relate with result and those that deal with the determinant of the result. Neely *et al.*, (2000) describe the dimension as a way of relating result measures as function of determinant measures. In other word, the result measures are lagging indicators while determinants measures are the leading indicators. In terms of strength, modified performance measurement matrix is able to specify in more detail, the nature of the measurement and also provide a basis for useful development. The model, on the other hand, suffers from the following shortcomings: It excludes customers and human resources as dimensions of performance. It is, to a great extent, complex to understand and use.

*Performance Pyramid Syste*m: The main aim of this model, proposed by Cross and Lynch (1992), is to link organisation strategy with its operation in a pyramid built on four levels. The pyramid creates a link through which an organisation's strategy is translated to operation. In precise terms, objectives are translated to operational activities from top-down, while the performance measures are built from the bottom-up (Tangen, 2004).The four-level objectives relate to an organisation's external effectiveness as well as internal efficiency. The first level of the pyramid provides description of overall corporate vision divided into individual business unit objectives. At the second level, short-term and long-term goals are set; while the third level contains day-to-day operational measures. The last level consists of four key indicators: quality, delivery, cycle time, and waste.

The model has the strength of integrating corporate objectives with operational performance indicators, as well as managing performance strategically. Unfortunately, performance pyramid system fails to provide any mechanism to identify key performance indicator and to specify form of measures.

Performance Prism: This is a three-dimensional model with a main objective of measuring performance of the whole organisation. It was developed by a team of experts: Neely, Adams and Kennerley (2001). Performance prism was conceptualised with five different faces representing specific areas of analysis. The faces are: stakeholders' satisfaction, strategy, process, capability and stakeholders' contribution. All faces of the prism are interrelated or linked sequentially. The needs or interests of the stakeholders inform the strategy to be put in place; the strategy forms the basis of the process while the capability is an off-shoot of the process. Performance Prism provides description of comprehensive measurement system that deals with key business issues applicable to profit and not-for-profit organisation (Neely, Adams & Crowe, 2001).

The positive side of this model is in its ability to reflect all new stakeholders such as employees, suppliers, alliance partners or intermediaries neglected in most performance measurement models. It also takes into consideration the stakeholder contribution into performance system, with emphasis on the need for strong foundation for all performance measures. However, the model is not explicit on how the performance measures are to be implemented. It also fails to provide strong logic between the results and drivers.

European Foundation for Quality Management (EFQM): with the support of the European Commission and European Organisation for Quality, this model was introduced in 1991 to assist organisations to track their progress to excellence and continuous improvement (Striteska *et al.,2012)*. The model is based on eight fundamental concepts of excellence: results orientation; people development and involvement; customer focus; continuous learning, innovation and improvement; leadership and constancy of purpose; partnership development; management by process and fact; and public responsibility.

For the model to achieve its objective of tracking progress of excellence, the fundamental concepts are further expressed and classified into five key drivers or enablers and four outcomes or results. Within this model are five drivers: leadership, people, policy and strategy, partnership and resources, and processes. These drivers are expected to propel the four results of people, customer, society and key performance outcome. The criteria of enabler and results are further classified into thirty-two sub-criteria addressing typical areas of importance. The model, as a self-assessment tool, has the capacity to assist managers in conducting comprehensive, systematic and regular review of an organisation's activities and result through a methodology entailing five steps: determination of required results, planning and development of approaches, assessment and review of results achieved. Firms such as health institutions, schools, public safety services, and local government institutions and many more find the model to be very useful across Europe.

In reference to its strengths, the model strengthens the sense of quality. It recognises the strong and weak points of organisations; allows shortlisting of indicators based on reference to good practice,

creates basis for comparison of business process with external business, and it allows feedback from result to improve the drivers. Some of the weaknesses suffered by the model are: it has the tendency to encourage bureaucracy; does not give clear guideline on how to design and conduct effective performance measurement; it may not be suitable for effective enterprise communication, and finally, it is not an instrument for strategy implementation (Striteska *et al.,2012).*

5. Conclusion

Performance measurement, as identified in this piece, assists organisations in many ways It ranges from provision of information for both strategic and operation purposes to continually motivating managers and subordinates to pursue organisational goals. But organisations can only drive these benefits maximally through a model that combines both the leading and lagging indicators such that the present and future scenarios of organisations are adequately captured. Numerous models with these peculiarities have been developed and are abound in the literatures. The most common and well cited are those reviewed in this paper.

With all these varieties of models at the disposal of organisations, managers need to make the choice of a model that has a semblance of the organisation's context to get the maximum benefits inherent in the selected model. It would also provide measures to tackle any shortcoming the chosen model may possess. For an organisation to choose an effective performance measurement model, this paper is of the opinion that such decision should be initiated by following the six steps suggested by CIMA (2008):

Development of effective performance measurement system

i. The performance measurement system must be integrated with the overall strategy of the business.

ii. There must be a system of regular feedback and review of actual results against the original plan and the performance measures themselves.

iii. The performance measurement system must be comprehensive. It needs to include the range of factors that contribute to the organisation's success such as competitive performance, quality of service and innovation. This requires a range of financial and non-financial indicators.

iv. The system must be owned and supported throughout the organisation. The implementation must be top-down so that individuals setting strategy can determine the objectives and develop appropriate top-level measures. These should filter down to the rest of the organisation. Other levels throughout the organisation should set their own measures in consultation with the level above and these must be consistent with the top-level measures.

v. Measures need to be fair and achievable. Where performance measures are used to reward managers' performance, the evaluation should include only the elements they have direct control over.

vi. The system and results reporting need to be simple, clear and understandable, particularly to non-finance professionals. There is a need to prioritise and focus so that only the key performance indicators for the business in strategic terms are measured.

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