

THE ECONOMIC AND FINANCIAL PERFORMANCE OF THE COMPANY. EVALUATION INDICATORS OF THE PERFORMANCE

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Abstract: The performance represents the degree to which a company can satisfy both the requirements of the internal environment and of the external environment, through an optimal combination between efficiency and effectiveness. In today's competitive environment, companies are under pressure to manage their costs more rigorously. But organizations are moving beyond just the quick wins and are searching for more long-term strategies to help enable leaner and ever more efficient operations.

1. Introduction

Financial management is the process of planning decisions in order to maximize the owner's wealth. Financial managers have a major role in cash management, the acquisition of funds and in all aspects of raising and allocating financial capital and taking into account the trade-off between risk and return. Financial managers need accounting and financial information to carry out their responsibilities.

Accounting provides financial information and includes financial accounting and managerial accounting. Financial accounting records the financial history of the business and involves the preparation of reports for use by external parties. Managerial accounting provides financial information to be used in making decisions about the future of the company. Accounting information is used by financial managers to make decisions regarding the receipt and use of funds to meet corporate objectives and to forecast future financing needs. The finance function analyzes the accounting information to improve decisions affecting the company's wealth.

Company goals usually include stockholder wealth maximization, profit maximization, managerial reward maximization, behavioral goals, and social responsibility. Modern managerial finance theory operates on assumption that the primary goal of the business is to maximize the wealth of its stockholders, which translates into maximizing the price of the firm's common stock. A strong trend is emerging as companies' strategies to improve costs are increasingly closely aligned with strategies to improve overall operation performance, thereby helping to increase shareholder value, customer satisfaction and confidence of shareholders.

The concept of risk-return trade-off is integral to the theory of finance. Risk refers to the variability of expected returns (sales, earnings or cash flow) and is probability that a financial problem will affect the company's operational performance or financial position. Typical forms of risk are economic risk, political uncertainties and industry problems.

2. Measurement managerial performance

Companies must to be able to measure managerial performance if they are to control operations and achieve organizational goals. As companies grow or their activities become more complex, they often attempt to decentralize decision making as much as possible by restructuring into several division and treating each as an independent business [5].

The essence of performance measurement is to determine how well 'somebody', or 'something', is doing although it should be noted that the 'something' will always, ultimately, be 'somebody's' responsibility.

There are three important questions: What are the key aspects of the organization, or of each separate part of the organization, that should be measured? What is the appropriate measure of performance for each key aspect? What is the appropriate benchmark, in each case, against which to evaluate performance?

Almost anything can be measured in some way. Something should be measured if it is meaningful and useful for a particular organization at a particular time. The same principles apply to all organizations, whether manufacturing or service, whether public or private, whether profit or non-profit. The practice is likely to be more difficult in some organizations than others (not just what to measure but also how to measure and how to benchmark performance) and for some aspects more so than others.

Traditionally, the focus of performance measurement has been on financial outcomes (effects) because:

- the profit motive is a driving force for commercial organizations,
- financial outcomes (in terms of sales, costs and profit) are very measurable.

Gradually, but increasingly, there has been a recognition, in both the literature and in practice, that focus needs to be placed on the wide variety of underlying factors (causes) that influence financial (and other) outcomes (i.e. on the key drivers of sales, costs and thus profit). This should encompass the external as well as the internal environment in its scope, and in such a way that recognizes the importance of an organization's strategies and objectives.

Thus, for example, if the quality of customer service is a key element of an organization's strategy then it should be measured in some way and will be a key indicator of sales performance. Factors such as customer satisfaction, competitiveness, product quality, order lead time, flexibility, resource utilization, speed and degree of innovation, quality of working life and employee satisfaction, and technological support may, for example, be seen as important in an organization as indicators of financial performance.

As a result of this broader approach a wide variety of performance measures have developed which need to be tailored in each separate case according to:

- the nature of the organization;
- the competitive environment within which it operates;
- the organization's strategies.

The concept of the 'balanced scorecard' is now commonly used to help direct attention to, and collect together, a range of performance measures that consider customers, suppliers and competitors as well as the internal environment of the organization itself. It is important at the same time not to overwhelm the organization with too many measures. At each level of management in the organization, and for each separate part of an organization (e.g. market, division, function, department) critical success factors, i.e. key drivers of success, need to be identified. It is vital that measures at one level, or in one part, of an organization are consistent with, and support, those above/in other areas.

Quality in all aspects of an organization's activities should be seen as vital to efficient and effective operations and ultimately to customer satisfaction. A Total Quality Management philosophy and environment supports, but certainly does not replace, the focus on, and measurement of, key aspects of organizational performance.

3. Evaluation indicators of the performance of the company

Starting from the concept of business performance, it is necessary to build a system of indicators which can provide the most accurate measurement of the concepts used in the business performance analysis. The system must be built to ensure the measurement of the performances and to allow the identification of the relationships, that are established between the different categories of indicators.

Measures used to assess performance in relation to the key aspects identified may be [4]:

- quantitative or qualitative;
- financial or non-financial;
- absolute or relative.

Quantitative (rather than qualitative) measures are most common and should be used wherever possible because they are more objective. However, not everything can be easily quantified, for example standards of customer service or quality of working environment. Qualitative measures are more subjective and thus more open to interpretation/bias on the part of both, for example, customer and supplier or employee and employer.

Qualitative measures will be non-financial. Quantitative measures may be financial or non-financial. Both financial and non-financial measures have an important part to play in performance measurement. Direct measures of sales, costs and profit are obviously financial measures. Many supporting quantitative measures of key aspects of organization performance will be non-financial, for example measures to assess:

customer service (e.g. complaint response time); customer satisfaction (e.g. no. of customer complaints; complaints per customer; complaints per £ of sales); competitiveness (e.g. market share; customer base; % sales growth); product quality (e.g. no. of customer complaints; no. of product rejects; % rejects; customer returns % of total sales); delivery/lead time (e.g. no. of deliveries on time; % of deliveries on time) – applied to purchases as well as to sales; resource utilization (e.g. m/c hours worked % of capacity; m/c downtime % of m/c hours worked); employee satisfaction (e.g. labor turnover); innovation (e.g. length of product development cycle; % of total sales from new products).

Relative measures are frequently more useful than measures in absolute terms (contrast the examples above) because, by relating one aspect of business to another, they add meaning to absolute numbers and thus help to put performance into context/perspective. Thus, for example, complaints per customer may be more useful than simply the number of complaints; gross profit per unit (or as a % of sales) may be more useful than total gross profit; departmental costs in relation to an appropriate measure of activity/output may be more useful than simply total costs on their own; and cost control ratios may be more useful than standard cost variances in absolute terms.

Cost control ratios are especially useful, in the context of standard costs, for measuring manufacturing performance in aggregate for a mix of products. The concept of a 'standard hour' is useful in the calculation of control ratios. The 'standard hour' is the quantity of work achievable at standard performance, expressed in terms of a standard unit of work done in a standard period of time. Thus, for example, if the standard hour of Product A is 10 units and of Product B is 20 units, and 15,000 units and 12,000 units respectively of the two products are manufactured, then the total standard hours is 2,100 [(15,000 / 10) + (12,000 / 20)].

The measurement of aggregate output in standard hours can be used to calculate the following ratios [5]:

Efficiency = $\frac{\text{standard hours}}{\text{actual hours}}$

Capacity = $\frac{\text{actual hours}}{\text{budgeted hours}}$

Activity = $\frac{\text{standard hours}}{\text{budgeted hours}}$

The three ratios can be linked by, for example:

Activity = Efficiency x Capacity

However, determining how to measure (as with the determination of what to measure) is not without its difficulties. Whatever the measure used it will inevitably be easier to measure aspects that are repetitive and quantifiable, for example labor efficiency in a manufacturing organization with homogeneous products in routine processes.

Measurement, of some aspects anyway, may be more difficult in a service organization where each service provided is unique.

It is also important to consider controllability and responsibility. Ultimately individuals in an organization are held responsible for performance and performance measurement should be designed to motivate, and facilitate, performance improvement. It is necessary that the boundaries of individual responsibility are made as clear as possible (for examples are individuals responsible for cost alone or does their responsibility extend to profit (i.e. sales and costs) or even investment performance?). The elements within an individual's responsibility should as far as possible be controllable by that person. There are inevitably many overlaps and interdependencies that need to be carefully managed.

The key question always is whether the measure used is the most appropriate, fair and useful way of assessing performance in relation to the critical success factors identified. If measurement leads to improvement in performance in relation to a particular aspect then it is important that this is positive for the organization as a whole i.e. that actions taken enhance organization performance overall in relation to strategy and objectives. For example, it may be counterproductive if an improvement in delivery times is achieved at the expense of holding excessive stocks. A classic example is the use of return on capital employed (ROCE) as an investment centre performance measure. The use of ROCE may discourage investment in projects that add value because they reduce the average ROCE % earned.

The measurement of performance requires, in addition to each measure itself, a basis for assessing whether performance is below, above or in line with that reasonably expected. A benchmark is required which may be based upon:

- the trend of performance over time;
- the performance in a similar organization (internal or external) or similar part of an organization;
- a budget, target or standard (e.g. standard cost) set by management;
- where performance is monitored over time, indices are a useful way of measuring the degree of change and of helping to assess what might be achievable.

Inter-business/inter-departmental comparisons can also be useful where similar measurements are available and reasonably comparative.

Budgets, and/or targets arising from the strategic planning process, are also used extensively as a performance yardstick.

In the context of budgets, cost standards are commonly used especially in manufacturing organizations that have repetitive operations. However, standards can be set at different levels of achievement (basic, ideal, attainable, current).

A basic standard is a standard established for use over a long period, rather than simply in a single budget period, where gradual but sustained improvement in performance against the basic standard may be expected and achieved. Thus favorable variances against standard (and control ratios >100%) would be expected and allowed for in targets set.

An ideal standard is a standard that can only be achieved under the most favorable operating conditions, with no allowance for normal losses, waste or machine down-time. Ideal standards are also established for use, without change, over a long period of time to measure progress towards the ideal. Adverse variances against standard (and control ratios <100%) would be expected and allowed for in targets set.

An attainable standard is a standard that can be achieved under reasonable expectations of operating conditions whilst a current standard is a standard that relates to current conditions. Both attainable and current standards are short-term standards that would be used solely to measure current performance. With current standards a target control ratio of over 100% may be set (i.e. expectation of a positive variance).

There are motivational aspects to consider. Also, the level at which standards are set influences the performance expected in relation to standard (as illustrated above), and thus the interpretation of the measure that results. The principles of setting standards on different bases can be more generally applied in target setting, for example should targets be set at a level that is very difficult to achieve or at a level that is more easily achieved?

4. Conclusion

The business results represent a complex category, whose measurement requires using an indicators system. This work has tried to present some of the most used economic and financial indicators used in the companies, without claiming that I have covered them all. The measurement of the financial results of enterprises is carried out using widely accounting and financial data sources. Accounting information is used by financial managers to make decisions regarding to receipt and use of funds to meet corporate objectives and to forecast future needs. The finance function analyses the accounting information to improve decisions affecting the company's wealth.

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