

COMPANY PERFORMANCE MEASUREMENT AND REPORTING METHODS

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One of the priorities of economic research has been and remains the re-evaluation of the notion of performance and especially exploring and finding some indicators that would reflect as accurately as possible the subtleties of the economic entity.

The main purpose of this paper is to highlight the main company performance measurement and reporting methods. Performance is a concept that raises many question marks concerning the most accurate or the best method of reporting the performance at the company level. The research methodology has aimed at studying the Romanian and foreign specialized literature dealing with the analyzed field, studying magazines specialized on company performance measurement. If the financial performance measurement indicators are considered to offer an accurate image of the situation of the company, the modern approach through non-financial indicators offers a new perspective upon performance measurement, which is based on simplicity. In conclusion, after the theoretical study, I have noticed that the methods of performance measurement, reporting and interpretation are various, the opinions regarding the best performance measurement methods are contradictive and the companies prefer resorting to financial indicators that still play a more important role in the consolidation of the company performance measurement than the non-financial indicators do.

Keywords

Performance, performance measurement, financial indicators, non-financial indicators, profit and loss account

Jel codes: L25

1. Company performance – conceptual approaches

Performance will always remain a contested, continuously-evolving concept. The performance concept can be narrowed down through an almost infinite number of definitions, many of which refer to specific contexts or functional perspectives. Reaching a consensus regarding the definition of performance is difficult at the level of an entity, since we must take into account the type of activities a certain entity is specialized in and the different interests of the one involved. Most times the objectives of the entities tend to be vague, constantly shifting, controversial and, sometimes, contradictive. Under these circumstances, the performance is a subjective and multi-faceted phenomenon. As to what an economic entity is concerned, many shares may influence or are influenced by the activities provided by the respective entity and this is exactly why divergent perspectives regarding the performance exist on a large scale. The specialized literature offers no unitary outlook upon the concept of performance, it either gives particularized definitions, which encompass certain facets, or general definitions that are difficult to quantify (Siminică 2008: 107):

- M. Porter considers that the company performance depends upon its capacity of creating value for its clients;
- A. Buirguignon defines performance as reflecting the accomplishment of organizational objectives;
- Eli Cohen associates performance with efficiency, analyzing the results obtained by the company in comparison with the used resources;

- Philippe Lorino states that, for a company, performance represents what contributes to optimizing the value-cost couple and not only what contributes to diminishing the cost or raising the value;

- C. Marmuse considers performance to be the element that, on the long run, keeps the competition at a distance through a strong motivation (based on rewarding systems) of all the members of the organization.

Bourguignon's definition of performance, based on the *action-result-success* trinomial is very widely used in the specialized literature. The essence of this approach consists in defining the three dimensions as follows (Bourguignon 1997: 89-101):

- **action performance:** performance is a process and not a result that occurs at a certain point;

- **result performance** (result of the action): performance measurement is understood as an evaluation of the results obtained as the consequence of an activity (process). This meaning relates only to value: performance measurement is regarded as an ex-post evaluation of the obtained results.

- **success performance:** performance does not exist independently, but it depends on the company representation of success made by various categories of users of the accounting information.

Performance can be defined as a state of competitiveness of the economic entity, reached through an efficiency and productivity level, which ensures its durability on the market (Niculescu 2005: 43).

Professors C. Bărbulescu și C. Băgu have stated that performance represents the level of best obtained results. They consider that, correlative performance measurement implies concepts of competitiveness and competition advantage (Bărbulescu și Băgu 2001: 55). However, it is inevitable that the performance notion foregrounds efficiency and effectiveness and that expression indicators acquire a special diversity. Reaching a company-level performance implies direct or indirect re-evaluation of the competitiveness, competition advantage, efficiency and effectiveness concepts.

2. Financial performance measurement indicators

In the course of time, performance has been either measured through the size of the company or through its productivity and profit. Managerial accounting researchers have become aware of the fact that performance at an organizational level cannot be quantified only through accounting or financial indicators. Especially that in the new age organizations cannot raise their competitiveness only for the rapid development of new technologies represented by physical shares or by an excellent management of shares and financial debts.

In the specialized literature, financial indicators related to the company performance are presented in three large categories:

- **Accounting result and derivative indicators.** The accounting result is actually the result from the financial statement. It is a fundamental indicator that can be explained through a structural analysis of the profit and loss account, namely an analysis of the intermediary balances of administration. The accounting indicators present the company performance in absolute values. Using rate indicators is recommended for various comparisons: the personnel expenses balance in the turnover, the productivity rate, the commercial margin balance in the turnover, etc. These indicators offer an image concerning productivity;

- **Traditional productivity indicators.** These indicators offer information regarding productivity, namely, reporting is made at the value of the invested assets. The most well-known indicator is ROI (return on investment), determined as a ratio between result and invested values. A traditional productivity indicator is the *Financial productivity ratio* determined as a ratio between net result and company equity (known as ROE – return on equity in the specialized literature). The financial productivity ratio offers information that allow companies to make comparisons

regarding the productivity expected by shareholders and, therefore, to assess the financial attractiveness of the company. Another indicator used to evaluate the economic productivity is the Return on capital employed (all the used financing methods are being taken into consideration) determined as a ration between the operating result and the capital employed;

- **The new category of financial indicators.** A representative indicator is EVA (Economic Value Added), whose positive value suggests that the company has managed to create value from a strictly financial point of view after payment of all capital contributions and especially after payment of capital shareholders. The economic value added is determined based on the relation:

$$\text{Operating result} = \text{operating result} - (\text{average weighted cost of the capital} \times \text{adjusted capital employed}) \quad (1)$$

EVA is an indicator that is better related to the stock market flow than other financial measures. From the perspective of the local performance, this indicator is used for evaluating the performance of divisions at a group level.

Financial indicators offer a short-term perspective upon performance, which represents one of the limits most frequently formulated. The information offered by them do not allow for a good reactivity on behalf of the managers. Another limit is represented by the fact that financial indicators are indicators of result and not of process, they are the effect of decisions of various origins and, through time reporting, of various durations. The information offered by these indicators is often difficult to comprehend by the managers. Financial indicators are often the result of complex and even debatable calculations, requiring complex economic and financial knowledge. Generally, the information provided to the deciding factors must be obtained rapidly and it must be intelligible in order to facilitate quick decision-making.

The fields of interest concerning management, investors and creditors are presented in the following table, together with the most frequently used methods of performance measurement.

Table no. 1. Performance indicators according to segments and perspectives

Management	Investors/Shareholders	Creditors
Operational analysis	Investment productivity	Liquidity
Gross margin Profit margin Added value Gross revenue surplus Net revenue result Analysis of operational expenses Structural analysis Revenue leverage Comparative analysis	Net assets productivity Social capital productivity Earnings per share Cash flow per share Share quotation increase Total productivity for shareholders	General liquidity Acid test Liquidity value Financial leverage
Resource management	Profit usage	
Asset turnover Working capital management Stock turnover Receivables turnover Suppliers turnover	Dividend per share Dividend ratio Distribution/un-allocation ratio Dividend-coverage degree Dividends/Total assets	Leverage degree Financial stability (Debts/Capitalization) Financial autonomy (Debts/Equities)
Productivity	Market performance	Debt service

Economic productivity (net)	PER	Interest-coverage degree
Gross productivity	Cash-flow multiplication degree	Debt-coverage degree
Net assets productivity	Value on market/Accounting value	Fixed-expenses coverage degree
Economic value added	Relative movements of quotations	Cash-flow analysis
Economic profit	Value vectors	
Cash-flow productivity	Company value	
Free cash-flow		

Source: Helfert 2006: 113

All the three basic groups are interested in the success of the business, each from a different point of view. From the variety of the presented indicators, the crucial business test is the productivity of the invested capital and its effect upon the assets owned by the shareholders. These indicators are the best interpreters when they are approached as a system of correlations, sensitive to managerial decisions, which may be influenced by the evolution of the specific value-creating vectors.

Many individual indicators are, by nature, merely static elements and cannot be interpreted accurately in the context of activity dynamics. The drawbacks are connected to the limits of the traditional accounting principles. This way, the necessity that managers should adopt an economic perspective, based on cash flows, in order to consolidate the decision-making activity, which, on the long term, will also determine a performance based on accounting information, has been highlighted.

3. The profit and loss account – image of performance

The complex informational background of the financial statements has led to their being acknowledged, nationally, as well as internationally, as the manager's fundamental instruments on all organizational levels. Referring to their importance, P.A. Samuelson, Nobel prize winner for Economics, states: *it is compulsory for the modern man to gain at least some knowledge in the accounting elements. Everyone that works in economics must be able to understand the two essential mapping features, balance and the profit and loss account.* (Samuelson 1964: 107)

Alongside the other components of the financial statements, the profit and loss account provides information regarding the company performance, each company's objective and each investor's mission.

In time, the profit and loss account has been the subject of concern for specialists and normalizers.

As a first performance-reflection model, the profit and loss account has been outlined in 1494 by Luca Pacioli, who considered that "the purpose of each merchandiser is to make profit that is legal and competent for his sustenance" (Paciolo trans. by Rusu and Cuciureanu 1991).

The profit and loss account represents the effect of the operational decisions of the management upon the company performance, upon profit, and upon loss for shareholders for a certain period, respectively. The profit and loss calculated within this document increases or reduces shareholders' level of equities from the balance sheet. Therefore, the situation concerning the obtained results is a necessary extension of the balance, in order to gain accuracy regarding some important components of the modifications in shareholders' capital, and in order to offer detailed information necessary for the measurement of a company's performance.

The information regarding the company's performance, and especially regarding its productivity, reflected in the profit and loss account, is used for:

- evaluating potential modifications of the company's economic resources so that they can be controlled in the future. The information regarding performance changeability is therefore extremely important.

- anticipating the company's capacity of generating treasury flows with the existing resources.
- formulating statements regarding the company's efficiency in using new resources.

The presentation method of the profit and loss account varies from one country to another, according to the informational contents and the form of presentation. The impact of the implementation of the 4th Guideline by the European Union member states has generated a host of profit and loss account models. In countries like Belgium, France, Italy, Portugal and Spain it is illegal that commercial societies publish their profit and loss accounts with the classification according to functions. Even among the countries that allow the four models to be used there are various varieties of their usage, as can be seen in the following table:

Table nr. 2 Methods of the profit and loss accounts in the countries of the European Union

	According to functions		According to nature	
	Vertically	Horizontally	Vertically	Horizontally
Austria	X	X	*	X
Denmark	X	X	*	*
Finland	*	*	*	*
France	*	X	*	X
Germany	X	X	*	*
Greece	*	X	*	X
Ireland	*	*	X	X
Italy	*	*	*	*
Luxemburg	X	X	*	X
Great Britain	*	*	*	*
Holland	*	*	*	*
Portugal	*	*	*	*
Romania	*	*	*	*
Spain	X	X	X	*
Sweden	*	X	*	*
* = Permitted by national legislation				
X = Banned by national legislation				

Source: Ștefănescu 2005: 126

The development of the financial markets and of the financial communication requirements regarding future performance anticipation, imposed by the investors, requires a dynamic measurement of the performance. In order to accomplish this, two currents are fighting for supremacy in the accounting world: "current operating concept" and "all inclusive concept", referring to operations included in the determination of the result.

According to the "correct operating concept", in the profit and loss account only the consequences of normal operational transactions of the current fiscal year are to be included, while the ones that do not concern operations need to be reported upon the reserves. In this version, only the operational transactions allow for a pre-visualization of the companies' future performance.

The users of this concept remove all elements that are not significant to highlighting the performance in the balance from the profit and loss account.

The "all inclusive concept" implies including in the profit and loss account elements that involve the growth or decrease of equities in the fiscal year, except for dividends distribution or capital decrease due to distribution by shareholders, and shareholders' contributions, respectively.

This dual approach upon the result sets forth to offer the users an answer for two categories of needs: that of measuring the performance of the activities (current operating concept) and that of measuring enrichment (all inclusive concept).

In the last years the tendency to presents the company's performance in a single financial statement, rather than in two or more, has been noticed (Săcărin 2002: 128). This situation corresponds to the global result, an indicator that projects new dimensions upon the economic-financial performance analysis.

The measurement of the global result determines the dimension of the company's performance. It refers to the fluctuation in the company's equities, as a consequence of different sources, except for the ones generated the operations with the owners.

It is an indicator more encompassing than the result highlighted by the profit and loss account, since it also includes elements determined in the equities, but which do not transit the income and expenses accounts. Its analysis highlights the contribution of all production factors to the forming of the result, it its economic form.

The most complex understanding of the *global result* concept is offered by IFRS 1. From this point of view, the boundaries of the accounting result are overcome, and "differences of conversion, income or latent loss in the financial instrument, actuarial income and loss associated to provisions, the effect of modifications in accounting methods, and the correction of fundamental errors" are also included (Ristea and Jianu 2004: 226).

4. Non-financial indicators – a modern method of measuring performance

The new financial performance measurement trend that uses non-financial indicators has brought about severe criticism towards the financial indicators, including criticism towards their aggregated form, too slow in offering useful information that would aid the managers in understanding the deep causes of the issues or that would help them initiate quick corrective measures. In the last years, a growing number of companies have started to lay stress on the measurement of certain non-financial aspects that have a financial impact, which had not yet stirred the interest of the managers, such as the clients' loyalty, the satisfaction degree of the employees or other aspects concerning performance improvement, but which are not financial and have a later impact upon productivity.

Poincelot & Wegmann (2004) present them in opposition with the financial indicators: they are considered to be non-financial because they do not convey the financial objective of a company directly like the productivity indicators based on the result or on the turnover do and they can be qualitative or quantitative indicators, sometimes expressed in monetary value (for example the expenses for client-forming programs, client marketing expenses), as the authors emphasize. Considering the nature of the non-financial indicators, these cannot lead to a global evaluation of the company's value creation in arithmetic terms. For the evaluation and guidance of the performance, Poincelot & Wegmann generically term the non-financial indicators *non-financial criteria*.

As to what the *contractual approach* is concerned, the two authors present the advantages of introducing non-financial criteria in the systems of performance measurements:

- *the non-financial evaluation criteria facilitate the coherence between strategy and the assignment of decisional rights* either by playing the role of an incentive mechanism, or as an essential component of the control system, or the two roles mentioned above simultaneously, or as a proper modality of evaluation of the realized performance (therefore they represent a mechanism that stirs, controls and evaluates performance, since they are much more adapted than the financial criteria). Poincelot & Wegmann have noticed that these non-financial criteria predominate when the decisional function is decentralized.
- *using non-financial criteria may favor the internal coherence of the organizational architecture*. After studying various representative research papers (Jensen and Meckling 1992, 1998; Horngren et al. 2003), the author have reached the conclusion that in the contractual literature the relations between the organizational architecture and the non-financial criteria have not been clearly established.

- *presenting the non-financial indicators to the directors in the incentive agreements (agreements with bonus) as a means of reducing conflict* (conflicts between directors and shareholders, conflicts between directors and employees). To Ittner, Larcker & Rajan, the managerial incentive agreements based exclusively on financial dimensions are not the most efficient means of motivating the directors to act according to the interests of the shareholders (Ittner, Larcker & Rajan 1997: 231-255). This way, the three authors suggest using non-financial indicators, which quickly provide the shareholders with information regarding the effort put by the directors into creating value at the level of the organization (therefore, the presence of the non-financial indicators represents a means of reducing the conflict between the directors and the shareholders at the level of the organization).

The non-financial indicators for a company's performance measurement may unify the information offered by the financial indicators, but the fact that the process of creating a set of indicators that are relevant to the activity performed by each company is difficult, leads to their being less used. The application and analysis difficulty of these indicators is determined not only by the complexity of the process of selecting the information that is most relevant to the respective company, but also by the high costs required by the stages necessary in creating a set of activity-specific indicators.

The necessity of introducing the non-financial indicators in order to guide and evaluate a company's performance has been advocated by Kaplan and Norton, for instance: "the financial indicators cannot reflect the global performance of a company".

Any performance measurement system includes a subjective side as well. Therefore, using various indicators evaluated by various interested parts (partners) is recommended, the company thus benefiting from various points of view at the performance level.

5. Conclusions

The performance of a company implies entwining various types of abilities that characterize the activity of the company, such as: productivity, profitability or competitiveness. From a chronological point of view one may notice that the specialized literature as well as the exercise has emphasized the company's performance measurement through traditional financial indicators. In the past decade a new methodology of assessing performance at a microeconomic level has emerged and has developed, based on the company's capacity of creating value in the performed production and sales activity. These indicators that measure the internal and external value of the company (EVA, MVA) have developed as a consequence of the higher demands of the shareholders and of the market as well. As companies perform their activity in a more and more dynamic environment, analysts are more open to non-financial aspects when it comes to reaching certain conclusions concerning the company's performance.

Therefore, in order to measure a company's performance, it is necessary to resort not only to the financial results, but to a global vision upon inter-dependences between internal and external, quantitative and qualitative, technical and human, physical and financial parameters of the company management. Even though more and more analysts confirm the importance of analyzing non-financial indicators, the financial indicators will hold the supremacy in consolidating the measurement of the company's performance due to ease with which the results can be analyzed and interpreted.

In this context, one may state that an easy solution that can be adopted by each company when performance measurement is aimed at does not exist. Each organization that best characterizes the activity and its specific situation.

Acknowledgements

This article is a result of the project „Creșterea calității și a competitivității cercetării doctorale prin acordarea de burse”. This project is co-funded by the European Social Fund through The

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