After studying this chapter, you will be able to:

- **Discuss**, Traditional and Non-traditional approaches to Performance Measurement
- **Calculate/ Determine** which Non-financial measures are appropriate to analyze specific aspects of an entity’s performance and risk profile.
- **Explain** the role of performance measurement and control systems in value creation, strategy implementation and monitoring performance to improve strategies
- **Describe, Calculate, and Interpret**, Non-financial Performance Indicators (NFPIs) and suggest methods to improve the performance indicated
- **Analyze** past performance and suggest ways for improving Financial and Non-financial performance
- **Explain** the causes and problems created by short-termism and financial manipulation of results and suggest methods to encourage a long-term view
- **Explain and Interpret** the Balanced Scorecard, The Performance Pyramid, The Performance Prism, The Building Block Model
- **Analyze** performance in Not for Profit organizations
Responsibility accounting is the collection, summarization, and reporting of financial information where individual manager is held accountable for certain costs, revenue, or assets of the firm. The information is about the decision centers throughout the organization. It can also be called profitability accounting or activity accounting.

Responsibility accounting is apt where top management has delegated authority to make decisions. The idea behind responsibility accounting is that each manager’s performance should be judged by how well he or she manages those items under his or her control.

Performance measurement is directly linked to the organisational structure of a business. A distinction can be made between two categories of organisational structure for performance appraisal:

- Functional organisation structures.
- Divisionalised organisation structures.
Functional Organizational Structure

A functional organizational structure forms when a business departmentalizes, according to the basic business functions such as production and operations, marketing and finance. Small and medium-sized businesses frequently implement this organizational structure, which often includes a production and operations department, a finance department, and a marketing department. In a functional organizational structure, pricing, product mix and output decisions will be made by central management. Consequently, the functional managers in a centralized organization will have far less independence than divisional managers.

Divisional Organizational Structure

An organization with a divisional organizational structure has various divisions operating autonomously as business under a broad corporate framework according to geographical areas, markets, or products and services.
Generally, this type of organizational structure leads to a decentralization of the decision-making process. Using this structure, division heads are free to set selling prices, choose which market to sell in, make product mix and output decisions, and select suppliers.

The formation of separate divisions may lead to the delegation of different degrees of authority; for example, in some organizations a divisional manager may, in addition to having authority to make decisions on sources of supply and choice of markets, also have responsibility for making capital investment decisions. Performance measurement systems depend on the degree of decentralization involved. There are four recognized levels of decentralization as follows:

**Cost or Expense Centres**

Cost or Expense Centres are responsibility centres where the manager of such a centre or division is responsible for the costs associated with that centre and hence the main focus is cost minimisation. This level of decentralisation occurs normally in functional organisation types.

**Revenue Centres**

Revenue Centres are responsibility centres where the manager is totally concerned with raising revenue with no responsibility for costs. The key measures used in appraising performance would be monitoring sales variances from budget.

**Profit Centres**

Profit Centres are responsibility centres where the manager of such a centre or division has responsibility for both revenue and costs for the assets assigned to the division. Thus, performance is measured in terms of the difference between the revenues and costs that relate to a profit centre.

**Investment Centres**

Investment Centres are responsibility centres where the manager has responsibility for not just the revenues and costs relating to the centre, but also the assets that generate these costs and revenues and the investment decisions relating to disposal and acquisition of assets.

**DIVISIONAL PERFORMANCE MEASURES**

A good performance measure should

- Provide incentive to the divisional manager to make decisions which are in the best interests of the overall company (goal congruence).
- Only include factors for which the divisional manager can be held accountable.
- Recognise the long-term objectives as well as short-term objectives of the organisation.
Return on Investment (ROI)

Instead of focusing purely on the absolute size of a division’s profits, most organizations focus on the ROI of a division. ROI expresses divisional profit as a percentage of the assets employed in the division. Assets employed can be defined as total divisional assets, assets controllable by the divisional manager or net assets. ROI is a common measure and thus is ideal for comparison across corporate divisions for companies of similar size and in similar sectors.

Goal Congruence

It is likely that divisional ROI can be increased by actions that will make the company as a Return on Investment whole worse off and conversely, actions that decrease the divisional ROI may make the company as a whole better off. In other words, evaluating divisional managers on the basis of ROI may not encourage goal congruence. Consider the following example:
The manager of division α would be unwilling to invest the additional ₹20 lacs because the return on the proposed project is 10%, and this would decrease the present ROI of 13%. On the other hand, the manager of division β would wish to invest the ₹20 lacs because the return on the proposed project of 7% is in excess of the present ROI of 5%, and it would increase the division’s ROI.

The managers of both divisions would make decisions that would not be in the best interests of the company. The company should accept only those projects where the ROI > Cost of Capital (8%), but the manager of division α would reject a possible return of 10% and the manager of division β would accept a possible return of 7%.

ROI can therefore lead to a lack of goal congruence.

**Residual Income (RI)**

To overcome some of the dysfunctional consequences of ROI, the residual income approach can be used. For the purpose of evaluating the performance of divisional managers, residual income is defined as controllable contribution less a cost of capital charge on the investment controllable by the divisional manager. For evaluating the economic performance of the division residual income can be defined as divisional contribution less a cost of capital charge on the total investment in assets employed by the division. If residual income is used to measure the managerial performance of investment centres, there is a greater probability that managers will be encouraged, when acting in their own best interests, also to act in the best interests of the company. Returning to our previous example in respect of the investment decision for divisions X and Y, the residual income calculations are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Division α ₹’lacs</th>
<th>Division β ₹’lacs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed Investment</td>
<td>20.00</td>
<td>20.00</td>
</tr>
<tr>
<td>Controllable Contribution</td>
<td>2.00</td>
<td>1.40</td>
</tr>
<tr>
<td>Cost of Capital (8%)</td>
<td>1.60</td>
<td>1.60</td>
</tr>
<tr>
<td>Residual Income</td>
<td>0.40</td>
<td>– 0.20</td>
</tr>
</tbody>
</table>

This calculation indicates that the residual income of division X will increase and that of division Y will decrease if both managers accept the project. Therefore, the manager of division X would invest, whereas the manager of division Y would not. These actions are in the best interests of the company as a whole.
Residual income suffers from the disadvantages of being an absolute measure, which means that it is difficult to compare the performance of a division with that of other divisions or companies of a different size. For example, a large division is more likely to earn a larger residual income than a small division. To overcome this deficiency, targeted or budgeted levels of residual income should be set for each division that are consistent with asset size and the market conditions of the divisions.

**Economic Value Added (EVA)**

In practice, many organizations use profit-based measures as the primary measure of their financial performance. Two problems relating to profit in this area are:

- Profit ignores the cost of equity capital. Companies only generate wealth when they generate a return in excess of the return required by providers of capital – both equity and debt. In financial statements, the calculation of profit does take into account the cost of debt finance, but ignores the cost of equity finance.

- Profits calculated in accordance with accounting standards do not truly reflect the wealth that has been created, and are subject to manipulation by accountants.

EVA is a performance measurement system that aims to overcome these two weaknesses.

Economic Value Added is a measure of economic profit. Economic Value Added is calculated as the difference between the Net Operating Profit After Tax (NOPAT) and the Opportunity Cost of Invested Capital. This opportunity cost is determined by multiplying the Weighted Average Cost of Debt and Equity Capital (WACC) and the amount of Capital Employed.

\[ \text{EVA} = \text{NOPAT} - \text{WACC} \times \text{Capital} \]

*Where-* NOPAT means net operating profit after tax. This profit figure shows profits before *taking out the cost of interest*.

Two approaches to adjusting for interest are taken.

- **Start with operating profit**, then deduct the adjusted tax charge. The tax charge should be adjusted because it includes the tax benefit of interest. Since interest is a tax-deductible item, having interest in the income statement means that the tax charge is lower. Since we are taking the cost of interest out of the income statement, it is also necessary to remove the tax benefit of it from the tax charge. To do this, multiply the interest by the tax rate, and add this to the tax charge, or

- **Start with profit after tax**, and add back the net cost of interest. This is the interest charge multiplied by \((1 – \text{rate of corporate tax})\).

**Example**

The following information is available for the division X of Xu Ltd:

| Net operating profit before interest and taxes | 7,500 |
| Depreciation expenses                        | 2,500 |
### EVA

EVA can be calculated as NOPAT minus the capital charge on invested capital. In this case, NOPAT is equal to net operating profit before interest and taxes $\text{Rs}7,500$ minus taxes $\text{Rs}2,250$ ($\text{Rs}7,500 \times 30\%$), which is equal to $\text{Rs}5,250$. EVA is then equal to $\text{Rs}4,250$ ($\text{Rs}5,250 - \text{Rs}12,500 \times 8\%)$.

### Shareholder Value Added (SVA)

A variation along the same concept as EVA. The main aim of the organisation is to add value to shareholder wealth.

In 1980’s Alfred Rappaport proposed a technique for value measurement. This approach is called Shareholder Value Analysis. SVA focuses less on process than Porter’s and acts more as a final gateway in decision making, although it can be used at multiple levels within a firm, SVA is described as

*The process of analyzing how decisions affect the net present value of cash to shareholders. The analysis measures a company’s ability to earn more than its total cost of capital...With in business units, SVA measures the value the unit has created by analyzing cash flows over time. At the corporate level, SVA provides framework for evaluating options for improving shareholder value by determining the tradeoffs between reinvesting in existing businesses, investing in new businesses and returning cash to stockholders.* (Rappaport, 1986, 1998)

Rappaport suggested that future cash flows should be discounted at a suitable cost of capital and that shareholder value would be increased if this measure were to increase. According to Rappaport, the following seven factors- he calls them “value driver”- affect shareholder value:

- Rate of Sales Growth
- Operating Profit Margin
- Income Tax Rate
- Investment in Working Capital
- Fixed Capital Investment
- Cost of Capital
- Life of the Project

It is important to remember that value is *not just a financial concept*. Shareholders can attach *non-financial value, e.g. social responsibility* of the company.

---

<table>
<thead>
<tr>
<th>Change in net working capital</th>
<th>1,250</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital expenditure</td>
<td>1,000</td>
</tr>
<tr>
<td>Invested capital</td>
<td>12,500</td>
</tr>
<tr>
<td>WACC</td>
<td>8%</td>
</tr>
<tr>
<td>Tax Rate</td>
<td>30%</td>
</tr>
</tbody>
</table>
Triple Bottom Line (TBL)

TBL expands traditional accountancy reporting systems, looking at social and environmental performance, rather than simply financial performance. This can be used to help encourage each division and manager within the organisation to act in a socially responsible manner. TBL incorporates the three dimensions-

- **Environmental** - measures the impact on resources, such as air, water, ground and waste emissions (Baumgartner & Ebner, 2010, p.79).
- **Social** - relates to corporate governance, motivation, incentives, health and safety, human capital development, human rights and ethical behaviour.
- **Economic** - refers to measures maintaining or improving the company’s success.

### Linking of Financial and Non-Financial Measures of Performance

The main objective of profit-making organizations is to maximize shareholder value. Hence, performance measures should be based on the value created by each division. Regrettably, using accounting measures such as ROI or EVA as performance measures can inspire managers to become short-term oriented. The incorporation of non-financial measures created the need to link financial and non-financial measures of performance. In particular, there was a need for a balanced set of measures that provide both short-term performance measures and also leading indicators of future financial performance from current actions.

The requirement to link financial and non-financial measures of performance and to identify key performance measures provided the impetus for:

- Kaplan and Norton’s 'Balanced Scorecard'
- Cross and Lynch’s ‘The Performance Pyramid'
- Fitzgerald and Moon’s ‘Building Block Model’
- Andy Neely and Chris Adams’s ‘The Performance Prism’

### Linking CSFs to KPIs and Corporate Strategy

It is easy to understand why Critical Success Factors (CSF) are often misunderstood as a synonymous or similar term to Key Performance Indicators (KPI). In reality, these two terms are actually very different and understanding the difference between these two terms is a vital step in implementing Business Performance Measurement.

Critical Success Factors are elements tied to the strategy of business and they represent objectives that businesses are trying to achieve, as a corporation, as a department, or as a business unit. They are derived from the strategic goals, and are in essence, an attempt to go one level deeper into the high-level strategic goals, and lay them out as a list of categorized objectives that will collectively drive the company’s strategy forward.

According to Rockart (1979), the following sources should be considered when identifying CSFs:
8.10 STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

- Industry Structure
- Competitive Strategy
- Environmental Factors
- Temporary Influences

To put it very simply, Critical Success Factors represent the ‘what’ – what are the things the company needs to do in order to achieve its goals.

Key Performance Indicators, on the other hand, are a consequence of critical success factors – they represent the ‘how’. Having outlined ‘what’ businesses want to achieve, a company must subsequently define sets of measures and associated targets in such a way that achieving those targets will translate into successful completion of a CSF.

For example, for an IT Department, a Critical Success Factor could be restoring normal service, and in order to achieve that, a logical KPI would be the Average Turnaround Time, with a target of 4 hours. The Average Turnaround Time and its target of 4 hours is the KPI that represents ‘how’ the IT department achieved its Critical Success Factor.

Ideally, each critical success factor should have a KPI associated with it. A single Critical Factor can also have more than one KPI, if need be. The KPI targets are more formally called thresholds, and the thresholds must be ascertained with a great deal of industry analysis, as well as internal analysis. KPI targets should be Specific, Measurable, Achievable, Relevant and Time Constrained.

In order to truly achieve effective measurement of business performance, the KPIs must be selected and designed in a way that ensures that the CSF is delivered if the KPI meets the threshold, and the CSFs in turn must be designed and constructed in a way that ensures that the company’s strategic vision is delivered if the CSFs are met.

The objectives, CSFs, and KPIs together represent a chain of links that together deliver a company’s strategic goal, by breaking down that strategic vision into a set of quantifiable targets, such as the Average Turnaround Time with a minimum of 4 hours in the case of the IT Department.

The CSFs should also be reviewed and evaluated with respect to the company’s high-level strategic goals. Having KPIs set up without a well governed feedback and monitoring process can result in a company aimlessly chasing targets which don’t ultimately deliver the company’s strategy.

Setting up KPIs is a step in the right direction, but the benefit of KPIs is only truly realized when they are implemented in the right way, and understanding their linked relationship with CSFs and objectives is paramount to this effect.
Balanced Scorecard

In today’s business environment information becomes a vital element and to gain competitive advantage over the peers, it cannot be denied. In this era of information age competition, a company cannot survive just by injecting huge capital investment in new technology for physical assets only or by excellent management of financial assets and liabilities. In this information age both manufacturing and service organisation needs new capabilities for competitive success. Merely investing in and managing physical, tangible assets is not enough but an organisation must be able to mobilise and exploit its intangible or invisible assets which in turn becomes a decisive factor.

Intangible assets enable an organisation to:

- Maintain and further development in customer relationships to retain loyalty of existing customers and to serve new market/customer segments effectively and efficiently.
- Introduce products and services as per the desire of targeted customer and market segments.
- Produce customised high-quality products and services economically with short gestation periods.
- Mobilise employee skills and motivation for better and consistent deliberation in process capabilities, quality, and response times.
- Deploy information technology, data bases and effective management information systems.

The balanced scorecard is a method which displays organisation’s performance into four dimensions namely financial, customer, internal and innovation. The four dimensions acknowledge the interest of shareholders, customers and employees taking into account of both long-term and short-term goals.

Kaplan and Norton classified performance measures into four business ‘perspectives’:

(i) The financial perspective
(ii) The customer perspective
(iii) The internal business perspective
(iv) The learning and growth perspective

Financial Perspective: “How Do We Look To Shareholders?” In this step manager of a division or a unit, links its business objectives to the corporate strategy of the company as a whole. Financial performance measures indicate whether the company’s strategy implementation and execution are contributing to its revenue and earnings. To identify key performance measures in this perspective, managers, during strategic planning ask “How do we look to shareholders?”

Corporate strategy and strategic initiatives are examined from the financial perspective to see feasibility of these initiatives of being met. The financial objectives chosen at the onset of the balanced scorecard implementation should serve two purposes:
• To provide definite performance that was expected at the time of strategies selection.
• To provide a focus for objectives and appropriate measures in each of the other three perspectives.

**Customer Perspective:** “How Do Customer View Us?” In this stage, companies identify customers and market segments in which they compete and also the means by which they provide value to these customers and markets. Managers identify the lead indicators which make a particular business unit or product different from that of others. Lead indicator may vary from customer to customer or market segment. If for example, a customer values on-time delivery then on-time delivery becomes a lead indicator. Examples of lead indicators may include any number of customer considerations, including:

- On-time delivery
- On-site service
- After sales support
- Defects per order
- Cost of the product
- Free shipments etc.

By delivering quality as per the customer demand and need, business units can improve outcome measures such as customer satisfaction, retention, acquisition and loyalty.

**Internal Business Perspective:** “At What Must We Excel?” In this stage companies identify processes and activities which are necessary to achieve the objectives as identified at financial perspectives and customer perspective stage. These objectives may be achieved by reassessing the value chain and making necessary changes to the existing operating activities. If maintaining net earnings is the financial objective of a company and after sales service can increase customer retention, then internal business perspective needs to improve after sales services to satisfy customer requirements to maintain net earnings. This objective may be achieved by providing for example toll free customer help lines, setting up service centres in all major cities.

**Learning and Growth Perspective:** “How Do We Continue To Improve And Create Value?” In the learning and growth perspective, Companies determine the activities and infrastructure that the company must build to create long term growth, which are necessary to achieve the objectives set in the previous three perspectives. Organisational learning and growth comes from three principle sources:

- People i.e. employee capabilities
- Systems i.e. information system capabilities and
- Organisational procedures i.e. motivation, empowerment and alignment.

Since, the balanced scorecard is intended to improve long-term performance, managers may invest in resources needed in the short-run but this should not affect business unit’s performance.
The ultimate result of using the Balanced Scorecard approach should be an improved long term financial performance. Since the scorecard gives equal importance to the relevant non-financial measures, it should discourage the short termism that leads to cuts in spending on new product development, human resource development etc which are ultimately detrimental for the future prospects of the company.

The responsibility to devise and implement a Balanced Scorecard should be that of the managers working with the business. Since every company is different, it shall need to work out for itself the various financial and non-financial measures, which need to be focused upon for its own development. Since the Balanced Scorecard is recommended as a management tool used both for internal and external reporting purposes, it is again the manager’s responsibility to decide as to what information needs to be disclosed and how any problems of confidentiality can best be overcome.

The following are some reasons why Balanced Scorecards sometimes fail to provide for the desired results:

- Managers mistakenly think that since they already use non-financial measures, they already have a Balanced Scorecard.
- Senior executives misguidedly delegate the responsibility of the Scorecard implementation to middle level managers.
- Company’s try to copy measures and strategies used by the best companies rather than developing their own measures suited for the environment under which they function.
- There are times when Balanced Scorecards are thought to be meant for reporting purposes only. This notion does not allow a Business to use the Scorecard to manage Business in a new and more effective way.

It may be noted that the above-mentioned difficulties refer to the internal use of the Scorecard, unless it is used internally successfully, it should not be used as a basis for external reporting.

The following figure summarises the ideas of a Balanced Scorecard:
8.14 STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

Strategy Mapping

The Strategy Map shows the objectives needed to execute the strategy. The balanced score card is a part of system that translates strategy into action. Strategy maps can be created for not-for-profit and public service entities, as well as for-profit enterprises.

Example of Strategy Mapping
Illustration

Standard Telecom Ltd. is a leading cellular service provider having a global presence. It aims to be the most innovative and trusted telecom company in the world. To achieve this aim, it is constantly working on its overall functioning. It is trying to adopt best managements practices in the world. Following are some information related to the company’s performance for a particular period:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Current Year</th>
<th>Base Year</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Ratio</td>
<td>60%</td>
<td>54%</td>
<td>Reduce it to 50%</td>
</tr>
<tr>
<td>Average Revenue per user</td>
<td>₹225</td>
<td>₹210</td>
<td>Increase it to ₹250</td>
</tr>
<tr>
<td>Unresolved Consumer Complaints</td>
<td>27,500</td>
<td>25,000</td>
<td>Reduce it by 20%</td>
</tr>
<tr>
<td>Customer Relationship Centres</td>
<td>280</td>
<td>200</td>
<td>Take the total to 250</td>
</tr>
<tr>
<td>Employee Coverage under Training Programme</td>
<td>10%</td>
<td>8%</td>
<td>At least 15%</td>
</tr>
</tbody>
</table>

Required

ANALYSE the performance of the company using Balance Scorecard approach.

Solution

The balanced scorecard is a method which displays organisation’s performance into four dimensions namely financial, customer, internal and innovation. The four dimensions acknowledge the interest of shareholders, customers and employees taking into account of both long-term and short-term goals. The detailed analysis of performance of the company using Balance Scorecard approach as follows:

(i) **Financial Perspective:** Operating ratio and average revenue will be covered in this perspective.

  Company is unable to achieve its target of reducing operating ratio to 50% instead it has increased to 60%. Company is required to take appropriate steps to control and manage its operating expenses. Average revenue per user has increased from ₹210 to ₹225 but remains short of targeted ₹250. This is also one of the reasons of swelled operating ratio. Company can boost up its average revenue per user either by increasing the price of its services or by providing more paid value added services.

(ii) **Customer Perspective:** Service complaints will be covered under this perspective. The company had set a target of reducing unresolved complaints by 20% instead unresolved complaints have risen by 10% \([27,500 - 25,000] \div (25,000) \times 100\). It shows dissatisfaction is increasing among the consumers which would adversely impact the consumer’s general perception about the company and company may lose its consumers in long run.

(iii) **Internal Business Perspective:** Establishing customer relationship centres will be covered under this perspective. Company has established 80 relationship centres in the current period exceeding its target of 50 (250-200) to cater to the needs of existing consumers as well as soliciting new consumers. This shows the seriousness of the company towards the consumer satisfaction and would help them in the long run.
(iv) **Learning and Growth Perspective:** Employee training programmes are covered under this perspective.

Company had set a target to cover at least 15% employee under its training programmes but covered only 10%. This could hurt capabilities of the employees which are needed for long term growth of the organisation necessary to achieve the objectives set in the previous three perspectives. People or the human resource of the company is one of the three principle sources where organisational learning and growth comes.

**Balanced Scorecard in Practice**

<table>
<thead>
<tr>
<th>Scorecard Category/Strategic Objective</th>
<th>Measures</th>
<th>Scorecard Weighting ‘At Target’ (Range of Outcomes)</th>
<th>Actual Outcome</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group Profitability</td>
<td>Underlying Profit Before Tax (PBT)</td>
<td>50% (0–100%)</td>
<td></td>
<td>The Underlying PBT result of $1,532 million for 2015/2016 exceeded the ‘overdrive’ target set by the Board. Therefore, this measure contributed a maximum overdrive outcome of 100 per cent (out of 50 per cent) to the STIP scorecard.</td>
</tr>
<tr>
<td>Qantas Transformation and the Cost Agenda</td>
<td>Deliver transformation benefits Unit cost</td>
<td>20% (0–30%)</td>
<td></td>
<td>Management’s commitment and focus on the Qantas Transformation program to date has delivered $1,655 million of benefits. During 2015/2016 the Group realised $557 million in cost and revenue benefits through transformation initiatives, exceeding the full year target of $450 million announced to the market in February 2016. Qantas International, Qantas Domestic and Jetstar Group exceeded the unit cost target set.</td>
</tr>
<tr>
<td>People and Operational Safety</td>
<td>People Safety measures Board’s assessment of Operational Safety</td>
<td>10% (0–15%)</td>
<td></td>
<td>Management’s continued focus on Operational and People safety resulted in targeted improvements in People Safety metrics being achieved and good Operational Safety for the year. Therefore, there was an at target contribution under the People Safety and the Operational Safety measures.</td>
</tr>
</tbody>
</table>
8.18 STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

### Customer

| Customer | Net Promoter Score (NPS) | Punctuality Domestic network attractiveness | 10% (0–15%) | The Board recognised that Management’s continued investment in the customer has resulted in NPS targets for Qantas International, Qantas Domestic and Qantas Frequent Flyer being exceeded. NPS targets were not achieved by Jetstar Domestic, however, above threshold or above target NPS results were achieved by other Jetstar Group Airlines. Qantas Domestic exceeded its on-time performance target for 2015/2016, with 89.7 per cent of flights on-time. Qantas Domestic and Jetstar also maintained the Group’s network advantage in the Australian domestic market.

### Growth and Strategic Initiatives

| Growth and Strategic Initiatives | Qantas Loyalty: EBIT growth Investments in Jetstar Airlines in Asia: Underlying EBIT Revenue Management System Milestones and project benefits | 10% (0–15%) | Management continued to grow diversified earnings and pursue growth opportunities. Qantas Loyalty achieved its Earnings Before Interest and Tax (EBIT) growth target for 2015/2016. Earnings targets for the two key Jetstar Airlines in Asia, Jetstar Asia and Jetstar Japan were exceeded. Qantas Revenue Management System key project milestones and review benefits were achieved.

### 2015/16 STIP Scorecard

<table>
<thead>
<tr>
<th>2015/16 STIP Scorecard</th>
<th>Outcome</th>
<th>STIP Scorecard</th>
<th>100% (0–175%)</th>
<th>160%</th>
</tr>
</thead>
</table>

**Key:**

- **Above target achievement against targets**
- **Full achievement against targets**
- **Partial achievement against targets**
- **No achievements against targets**

(Source: Qantas Airways ‘Annual Report’ 2016)
Performance Pyramid

The Performance Pyramid also known as Strategic Measurement and Reporting Technique by Cross and Lynch 1991. They viewed businesses as performance pyramids. The attractiveness of this framework is that it links the business strategy with day-to-day operations. The analogy of building a house can be applied here. To build a strong house one must start with a proper foundation in order to build a house which structurally sound and one that will last.

In the above pictorial presentation:
- ‘Objectives’ are shown from top to bottom.
- ‘Measures’ are from bottom to the top.
- At the top is the organization’s corporate vision through which long term success and competitive advantages are described.
- The ‘business level’ focuses on achievements of organization’s CSF in terms of market and financial measures.
The marketing and financial success of a proposal is the initial focus for the achievement of corporate vision.

The above business are linked to achieving customers satisfaction, increase in flexibility and high productivity.

The above driving forces can be monitored using the operating forces of the organization.

The left-hand side of the pyramid contains external forces which are ‘non-financial’.

On the other hand, the right-hand side of the pyramid contains internal efficiency which are predominantly ‘financial’ in nature.

David Otley (2005) has observed that other related frameworks exist, such as the results and determinants framework by Fitzgerald (1991), the balanced scorecard by Kaplan and Norton (1992) and Neely’s performance prism. A common thread in all of them is that performance measures should:

- be allied to corporate strategy.
- include internal as well as external measures.
- include financial as well as non-financial measures.
- make explicit the trade-offs between different dimensions of performance.
- include all important but difficult to measure factors as well as easily measurable ones.
- consider measures for managers/employees’ motivation.

**Illustration**

You are a paid assistant working in SBC LLP – an accounts consultancy firm. You have received the following email from one of SBC’s senior partner:

**To:** DG  
**From:** SB  
**Date:** 22/06/20XX  
**Subject:** PEL meeting this afternoon

As you are probably aware, we are meeting with the managers of PEL later this afternoon to discuss several key issues, and I need you to do some research for me. I need a report that covers the following:

Analysis of the new proposal for the period 2015 to 2017 based on

- external effectiveness and
- internal efficiency

To help you with this, I’ve attached a copy of our forecast of PEL’s financial and non-financial data for the period 2015 to 2017. Please read it carefully and email me back as soon as possible so I have time to prepare before the meeting.

Thanks

SB
Background to PEL

Precision Engineering Ltd (PEL) specialises in engineering design and manufacture in the automotive and motorsport industry. PEL’s design team has many years’ experience in the design and development of engine components for the market and high performance engines. PEL has identified a number of key competitors and intends to emphasise on close co-operation with its customers in providing products to meet their specific engineering design and quality requirements. Efforts will be made to improve the effectiveness of all aspects of the cycle, from product design to after-sales service to customers. This will require data from a number of departments in the achievement of the specific goals of the new proposal. Efforts will be made to improve productivity in conjunction with increased flexibility of methods.

Forecast of PEL’s Financial and Non-Financial Data

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Market Size (`lacs)</td>
<td>110</td>
<td>115</td>
<td>120</td>
</tr>
<tr>
<td>PEL Sales (`lacs)</td>
<td>18</td>
<td>21</td>
<td>23</td>
</tr>
<tr>
<td>PEL Total Costs (`lacs)</td>
<td>14.10</td>
<td>12.72</td>
<td>12.55</td>
</tr>
<tr>
<td>Production Achieving Design Quality Standards</td>
<td>95.5%</td>
<td>98.0%</td>
<td>98.5%</td>
</tr>
<tr>
<td>Returns from Customers (% of Deliveries)</td>
<td>2.0%</td>
<td>1.0%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Cost of After-Sales Service (`lacs)</td>
<td>1.3</td>
<td>1.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Sales Meeting Planned Delivery Dates</td>
<td>85%</td>
<td>90%</td>
<td>95%</td>
</tr>
<tr>
<td>Average Cycle Time (Customer Enquiry to Delivery) (weeks)</td>
<td>5.0</td>
<td>4.5</td>
<td>4.0</td>
</tr>
<tr>
<td>Components Scrapped in Production (%)</td>
<td>6.5%</td>
<td>4.0%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Idle Machine Capacity (%)</td>
<td>9%</td>
<td>5%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Required

Draft the email as requested by the partner.

Solution

To: SB
From: DG
Date: 22/06/20XX
Subject: Re: PEL Meeting this afternoon

Please find below my analysis of the points you wished me to examine for PEL. Please let me know if you wish to discuss any of these points in more detail.

Kind regards

DG
External Effectiveness- The marketing success of the proposal is associated with the achievement of customer satisfaction. The success will need an efficient business operating system for all aspects of the cycle from product design to after-sales service to customers. Customer satisfaction is linked with improved quality and delivery. Quantitative measures of these factors are as follows:

- **Quality** is expected to improve. The percentage of production achieving design quality standards is expected to increase from 95.5% to 98.5% between 2015 and 2017. In the same period, returns from customers for replacement or rectification should drop from 2% to 0.5% and the cost of after-sales service should drop from ₹1.3lacs to ₹1.0lacs.

- **Delivery** efficiency improvement that is expected may be measured in terms of the rise in the percentage of goods achieving the planned delivery date. This percentage rises from 85% in 2015 to 95% in 2017.

Internal Efficiency- The financial success of the proposal is linked to the achievement of high productivity. This should be helped through reduced cycle time and decreased levels of waste. Quantitative measures of these factors are as follows:

- The average total cycle time from customer enquiry to delivery should drop from 5 weeks in 2015 to 4 weeks in 2017.

- **Waste** in the form of idle machine capacity is expected to drop from 9% to 1% between 2015 and 2017. Also, component production scrap is expected to drop from 6.5% in 2015 to 1.5% in 2017.

The Building Block Model

Fitzgerald and Moon proposed a Building Block Model which suggests the solution of performance measurement problems in service industries. But it can be applied to other manufacturing and retail businesses to evaluate business performance. Variants of the building block model are currently used in Australia in the regulation of electricity transmission and distribution, gas transmission and distribution, railways, postal services, urban water and sewerage services, irrigation infrastructure, and port access.
**Standards.** These are the measures used, i.e. the KPIs, should have the following characteristics:

*Equity-* Performance measures should be equally challenging for all parts of business. Relaxation given to one part of the business leads to perception of unfair treatment which hinders productivity.

*Ownership-* Performance measure should be acceptable to everyone. Employees should be got involved in the identification of measures rather than being imposed on them. Ownership means here is responsibility for the results.

*Achievable-* Performance measure should be realistic. Ex, using actual results for the competitors to set as target. Employee will not be motivated to achieve targets if consider them impossible.

*Rewards-* To ensure that employees are motivated to meet standards, the standards need to be clear and linked to controllable factors. Reward schemes should possess following characteristics:
**Motivation** - Rewards scheme should be set in manner which motivates employees to achieve the business goals. If sales growth is desired than bonus can be linked to performance measures, like increase in number of units sold than previous year.

**Clear** - Rewards scheme should be clearly communicated to employees in advance. What kind to performance will be rewarded and how their performance will be measured?

**Controllability** - Employees should only be reward or penalized of the result over which they some control or influence.

**Dimensions** - Dimensions are the goals for the business, i.e. the CSFs and suitable measures must be developed to measure each performance dimension. They are further divided into two sub-categories.

**Determinants** - These are performance areas which influence the results. These are.

- Quality - It is the ability to deliver goods and service with consistency. Quality should be judged from eyes of the customers. Quality is the level of benefits customers expects from the product. Quality should be enough for a product price paid.

- Flexibility - It is the responsiveness to change in the factor influencing the business performance. Ex, ability to cope with sudden increase in sales demand.

- Innovation - Ability of the business to devise new products and new ways of doing things. Like packaging of products with environment friendly (recyclable) material.

- Resource Utilization - It is the ability to use resources to achieve business objectives. Business assets should be used for the proper purpose and in most efficient way. Ex, using delivery vans to its maximum capacity only by carrying authorized goods.

**Results** - It reflects the success or failure of determinants identified above.

- Financial Performance - Financial performance gives an indication of overall business at a glance in monetary terms. These can be used to identify areas of strengths and weaknesses. It may also highlight other areas previous identified which may be critical to business success.

- Competitive Performance - How they stand in comparison to its competitors? How are the different from their competitors? Ex, offering of products of higher quality than competitors and products having distinct features than rival products.
### The Results and Determinants Framework

<table>
<thead>
<tr>
<th>Dimensions of Performance</th>
<th>Types of Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Results</strong></td>
<td></td>
</tr>
</tbody>
</table>
| Competitiveness           | • Relative Market Share and Position  
                           | • Sales Growth  
                           | • Measures of the Customer Base |
| Financial Performance     | • Profitability  
                           | • Liquidity  
                           | • Capital Structure  
                           | • Market Ratios |
| **Determinants**          |                   |
| Quality of Service        | • Reliability  
                           | • Responsiveness  
                           | • Aesthetics/appearance Communication  
                           | • Cleanliness/tidiness  
                           | • Comfort  
                           | • Friendliness  
                           | • Courtesy  
                           | • Competence  
                           | • Access  
                           | • Availability  
                           | • Security  
                           | • Communication |
| Flexibility               | • Volume Flexibility  
                           | • Delivery Speed Flexibility  
                           | • Specification Flexibility |
| Resource utilization      | • Productivity  
                           | • Efficiency |
| Innovation                | • Performance of the Innovation Process  
                           | • Performance of Individual Innovations |

(Source: Fitzgerald, 1991)
Performance Prism

Performance Prism creators Andy Neely and Chris Adams mentioned that the better-known Balanced Scorecard framework only focuses on two sets of stakeholders: shareholders and customers. The Performance Prism is an approach to performance management which aims to effectively meet the needs and requirements of all stakeholders. This is in contrast with the performance pyramid which tends to concentrate on customers and shareholders and is also in contrast with value based management, which prioritizes the needs of shareholders.

- It takes stakeholder requirements as the start point for the development of performance measures rather than the strategy of the organisation.
- It recognises the need to work with stakeholders to ensure that their needs are met.

There are five ‘facets’ to the Performance Prism which lead to key questions for strategy formulation and measurement design:

**Stakeholders Satisfaction**: The organization needs to focus on who are the stakeholders? What are the needs and wants of the stakeholders.

**Strategies**: What are the strategies required by the organization to fulfill the wants and needs of the stakeholders?

**Processes**: What are the necessary processes required for satisfying the above strategies?

**Capabilities**: What capabilities does the organization needs for operating and enhancing the process?

**Stakeholders Contributions**: It further takes into account what contribution does the management needs from its stakeholders?

**Comprehensiveness of Performance Prism**

The Performance Prism allows organisations to develop strategies, business processes and measures geared to the specific needs of all important stakeholder groups. By taking a broad stakeholder perspective that includes regulators and business communities, the PP enables an
organisation to more directly address the risks and opportunities in its business environment. Using the PP to develop measures for each relevant stakeholder facilitates the communication and implementation of strategy.

Performance Measures – Benefits
Berry, Broadbent and Otley (1995) suggest that the following benefits can be derived from the use of performance measures:

- Develops agreed measures of activity.
- Clarifies the objectives of the organization.
- Greater understanding of process.
- Helps facilitate comparison between divisions.
- Promotes accountability to stakeholder.
- Helps in setting of targets for managers.
- Helps facilitate comparison between different organizations

Performance Measures – Problems
Problems that may develop from the use of performance measures by an organization are as follows:

- Tunnel Vision
- Undue focus on measurements to the detriment of other areas
- Sub-optimization
- Focus on one measurement to the detriment of others
- Myopia
- Focusing too much on short-term measures and not looking long-term
- Misrepresentation
- Not presenting the data correctly
- Misinterpreting
- Misinterpreting the data
- Ossification
- Keeping of out of date measures
Benchmarking, technique for continuous improvement was originated in Japan during the early 1960s due to Japanese curiosity and fondness for achieving the best of best. Various forms of benchmarking have been used in industry for years. After 1980s with the advent of worldwide competition in key industries benchmarking come of age. Xerox, Motorola, Ford and other leading companies pioneered a much broader forms of benchmarking. These companies found benchmarking a valuable means of improving their competitiveness and effectiveness. It became an integral part of their continuous process improvement programme.

Benchmarking is a technique for continuous improvement in performance. It involves comparing a firm’s products, services or activities against other best performing organisations, either internal or external to the firm. The objective is to find out how the product, service or activity can be improved and ensure that the improvements are implemented. It attempts to identify an activity such as customer order processing needs to be improved and finding a non-rival organisation that is considered to represent world class best practice and studying how it performs the activity. It is a performance measure that provides the driving force to establish high performance and means to accomplish these goals. It is thus a component of a wider improvement process such as business process reengineering or quality improvement.

The benchmarking is a versatile tool that can be applied in a variety of ways to meet a range of requirements. The distinct types of benchmarks have been evolved over a period of time. Each has its own benefits and shortcomings and therefore each one is appropriate in certain circumstances then others.

The Benchmarking is of following types:

- **Competitive Benchmarking**: It involves the comparison of competitors products, processes and business results with own. Benchmarking partners are drawn from the same sector. However, to protect confidentiality it is common for the companies to undertake this type of benchmarking through trade associations or third parties.

- **Strategic Benchmarking**: It is similar to the process benchmarking in nature but differs in its scope and depth. It involves a systematic process by which a company seek to improve their overall performance by examining the long term strategies. It involves comparing high level aspects such as developing new products and services, core competencies etc.

- **Global Benchmarking**: It is a benchmarking through which distinction in international culture, business processes and trade practices across companies are bridged and their ramification for business process improvement are understood and utilised. Globalisation and advances in information technology leads to use this type of benchmarking.

- **Process Benchmarking**: It involves the comparison of an organisation critical business processes and operations against best practice organisation that performs similar work or deliver similar services. For example, how do best practice organisations process customers’ orders.
8.29 PERFORMANCE MEASUREMENT AND EVALUATION

- **Functional Benchmarking:** This type of benchmarking is used when organisations look to benchmark with partners drawn from different business sectors or areas of activity to find ways of improving similar functions or work processes. This sort of benchmarking can lead to innovation and dramatic improvements.

- **Internal Benchmarking** involves seeking partners from within the same organisation, for example, from business units located in different areas. The main advantages of internal benchmarking are that access to sensitive data and information are easier; standardised data is often readily available; and, usually less time and resources are needed. There may be fewer barriers to implementation as practices may be relatively easy to transfer across the same organisation. However, real innovation may be lacking and best in class performance is more likely to be found through external benchmarking.

- **External Benchmarking** involves seeking help of outside organisations that are known to be best in class. External benchmarking provides opportunities of learning from those who are at the leading edge, although it must be remembered that not every best practice solution can be transferred to others. In addition, this type of benchmarking may take up more time and resource to ensure the comparability of data and information, the credibility of the findings and the development of sound recommendations.

The benchmarking can be categorised into:

(i) **Intra-Group Benchmarking:** In intra group benchmarking the groups of companies in the same industry agree that similar units within the cooperating companies will pool data on their process. The processes are benchmarked against each other at or operational level. ‘Improvement task forces’ are established to identify and transfer best practice to all members of the group.

(ii) **Inter-Industry Benchmarking:** In inter-industry benchmarking a non-competing business with similar process is identified and asked to participate in a benchmarking exercise. For example, a publisher of school book may approach a publisher of university level books to establish a benchmarking relationship. Although two publishers are not in direct competition but there are obviously many similarities in their business with respect to sources of supply, distribution channels. Each will be able to benefit from the experience of other and establish ‘best practices’ in their common business processes.

**Goals of Benchmarking**

Benchmarking can deliver significant performance improvements and returns based on efficiency, cost savings and new revenues. Benchmarking projects typically target cycle times, productivity, customer service, quality and production costs. They also can be part of an effort to shift the culture of a company to be more customer oriented and results focussed.
Process of Benchmarking

The process of benchmarking requires a Company to identify the areas i.e. processes, activity etc. which are central to its business and then selects the top-performing companies in those areas. By analyzing how that excellence is achieved, the company learns lessons to apply to its own processes.

The benchmarking process is comprised of following stages. These stages are:

1. Planning
   - Determination of benchmarking goal statement: This requires identification of areas to be benchmarked. In practice, one should start with the identification of those areas which have to be really good to be really successful. One should start with the areas which account for most of the expenditure or which tie up the most of cash. One should remember that one cannot benchmark own performance until one have reliable and efficient systems of measurement in its own organisation. This applies irrespective of whether our benchmarking partners are internal or external, in parallel or in totally different business sectors. For identification of areas to be benchmarked the following criteria are used:
     - What would make the most significant improvements in our relationships with our customers.
     - What would make the most significant improvements to our bottomline.
     
     *Benchmarks important for customer satisfaction may include:*
     - Consistency of product or service.
     - Process cycle time.
     - Delivery performance.
     - Responsiveness to customer requirements.
     - Adaptability to special needs.
Benchmarks important for direct impact on the bottomline may include:

- Waste and reject levels.
- Inventory levels.
- Work-in-Progress.
- Cost of sales.
- Sales per employee.

(ii) Identification of best performance: Once the benchmarked goal statement are defined, the next step is seeking the best of the breed or best of the best. Since practically to arrive at the best is both expensive and time consuming therefore it is better to identify company which has recorded performance success in a similar area.

(iii) Establishment of the benchmarking or process improvement team: Ideally this should include the persons who are most knowledgeable about the internal operations and will be directly affected by changes due to benchmarking.

(iv) Defining the relevant benchmarking measurement: Relevant measures will not include the measures used by the organisation today but they will be refined measures that comprehend the true performance differences. Developing good measurement is key to successful benchmarking.

Collection of Data and Information

The data gathering for benchmarking could be done through national/international clearing houses, mail surveys, suppliers, company visits, telephone, interviews etc. In recent years national and international clearing houses have been set up.

The collection of data and information involves following steps:

- Compile information and data on performance. They may include mapping processes.
- Select and contact partners.
- Develop with partners, a mutual understanding about the procedures to be followed and, if necessary, prepare a Benchmarking Protocol.
- Prepare questions and agree terminology and performance measures to be used.
- Distribute schedule of questions to each partner.
- Undertake information and data collection by chosen method for example, interviews, site-visits, telephone, fax and e-mail.
- Collect the findings to enable analysis.

Analysing the Findings

The analysing of finding of above step requires following:

- Review the findings and produce tables, charts and graphs to support the analysis.
8.32 STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

- Identify gaps in performance between our organisation and better performers.
- Seek explanations for the gaps in performance. The performance gaps can be positive, negative or zero.
- Ensure that comparisons are meaningful and credible.
- Communicate the findings to those who are affected.
- Identify realistic opportunities for improvements. The negative performance gap indicates an undesirable competitive position and provide a basis for performance improvement. If there is no gap it may indicate a neutral position relative to the performance being benchmarked. The zero position should be analysed for identifying means to transform its performance to a level of superiority or positive gap.

Recommendations

This involves:

Making recommendation: This requires:
- Deciding the feasibility of making the improvements in the light of the conditions that apply within own organisation.
- Agreement on the improvements that are likely to be feasible.
- Producing a report on the Benchmarking in which the recommendations are included.
- Obtaining the support of key stakeholder groups for making the changes needed.
- Developing action plan(s) for implementation.

Implementing recommendations:
- Implement the action plans.
- Monitor performance.
- Reward and communicate successes.
- Keep key stakeholders informed of progress.

Monitoring and Reviewing

This involves:
- Evaluating the benchmarking process undertaken and the results of the improvements against objectives and success criteria plus overall efficiency and effectiveness.
- Documenting the lessons learnt and make them available to others.
- Periodically re-considering the benchmarks for continuous improvement.

Pre-requisites for Successful Benchmarking

Irrespective of the type and scope of benchmarking, it will be important to ensure that:
- Senior mangers support benchmarking and are committed to continuous improvements;
The objectives are clearly defined at the outset;

The scope of the work is appropriate in the light of the objectives, resources, time available and the experience level of those involved;

Sufficient resources are available to complete projects within the required time scale;

Benchmarking teams have a clear picture of their organisation’s performance before approaching others for comparisons;

Benchmarking teams have the right skills and competencies;

Stakeholders, particularly staff and their representatives, are kept informed of the reasons for benchmarking.

**Difficulties in Implementation of Benchmarking**

- Benchmarking is a time consuming and at time difficult. It has significant requirement of staff time and company resources.
- Benchmarking implementation requires the direct involvement of the senior manager etc. The drive to be best in the industry or world cannot be delegated.
- It is likely that there is resistance from employees.
- Companies can become preoccupied with the measures. The goal becomes not to improve process but to match the best practices at any cost.
- The key element in benchmarking is the adaptation of a best practice to tailor it to a company’s needs and culture. Without that step, a company merely adopts another company’s process. This approach condemns benchmarking to fail.
- Companies often waste time in benchmarking non-critical functions.

**Benchmarking Code of Conduct**

Benchmarking - the process of identifying and learning from the best practices anywhere in the world - is a powerful tool for continuous improvement. To contribute to efficient, effective, and ethical benchmarking, individuals agree for themselves and their organization to be abide by the following principles for benchmarking with other organizations:

The following is a suggested Benchmarking code of conduct:

- **Principle of Legality**: Avoid discussions or actions that might lead to or imply an interest in restraint of trade: market or customer allocation schemes, price fixing, dealing arrangements, bid rigging, bribery or misappropriation. Do not discuss costs with competitors if costs are an element of pricing.

- **Principles of Exchange**: Be willing to provide the same level of information that you request, in any benchmarking exchange.
8.34 STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

- **Principle of Confidentiality**: Treat benchmarking interchange as something confidential to the individuals and organizations involved. Information obtained must not be communicated outside the partnering organizations without prior consent of participating benchmarking partners. An organization’s participation in a study should not be communicated externally without their permission.

- **Principle of Use**: Use information obtained through benchmarking partnering only for the purpose of improvement of operations within the partnering companies themselves. External use or communication of a benchmarking partner’s name with their data of observed practices requires permissions of that partner. Do not, as a consultant or client, extend one company’s benchmarking study findings to another without the first company’s permission.

- **Principle of First Party Contact**: Initiate contacts, whenever possible, though a benchmarking contact designated by the partner company. Obtain mutual agreement with the contact on any hand off of communication or responsibility to other parties.

- **Principle of Third Party Contact**: Obtain an individual’s permission before providing their name in response to a contact request.

- **Principle of Preparation**: Demonstrate commitment to the efficiency and effectiveness of the benchmarking process with adequate preparation at each process step; particularly, at initial partnering contact.

PERFORMANCE MEASUREMENT IN THE NOT FOR PROFIT SECTOR

It is important to understand the nature of not-for-profit organisation in order to appreciate the dynamics of performance evaluation in such organisations. Not-for-Profit organisations are generally formed for social causes (like healthcare, education, infrastructure development etc), environmental causes, charitable causes etc. They are also formed for rendering services to the members and operate on a no-profit and no-loss basis. Examples include professional bodies, societies formed for maintenance of residential complex, political parties etc. (Not-for-profit organisations are also referred to as NGOs, Charitable organisations, Voluntary organisations etc.)

As the name suggest, unlike in the case of a for-profit organisation, the underlying objective of these organisations is not to earn profits and distribute dividends to its members. The *for-profit* organisations have an ultimate objective of shareholder’s wealth maximisation and hence the performance can be measured using financial measures like profitability, return on net assets, economic value added, residual income etc. Since a not-for profit organisation is focused on certain causes and is not focused on financial returns, performance measurement can be tricky.

The not-for-profit organisations are formed for certain specific mission and objectives. For e.g. an organisation formed to provide free education to poor children is formed with a specific mission to provide access to education to those who are deprived. These organisations also need funds to achieve the mission and objectives which are contributed by donors and members. The organisation, thus, has fiduciary responsibilities to those contributing funds and must ensure that the funds are deployed to meet the intended mission and objectives. Thus, though the not-for-profit organisations are not focused towards earning profits, the financial measures are equally important as non-financial measures to measure their performance.
Why do we need performance measure in Not-for-Profit Organisations?

As discussed earlier, a not-for-profit organisation does not exist for earning profits but for achieving certain social or charitable cause. The activities carried out by such organisations must be measured to give a confidence to the donors/members that the resources contributed are being utilised efficiently and effectively.

However, performance measurement in such not-for-profit organisations is not easy. The following are key challenges for measuring performance in not-for-profit organisations –

<table>
<thead>
<tr>
<th>Benefits cannot be quantified</th>
<th>Benefits may accrue over a longer term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key Challenges</td>
<td></td>
</tr>
<tr>
<td>Measurement of utilisation of funds &amp; expenditure</td>
<td>Multiple objectives</td>
</tr>
</tbody>
</table>

**Benefits cannot be quantified**

A large part of benefits derived from the activities of these organisations are not quantifiable. For example - if a not-for-profit organisation is formed for providing free education to poor students, the benefits derived by the students cannot be quantified. In some cases, an organisation might spend money to provide better ambulance services to its patient. The benefits of saving lives of patients cannot be measured in financial terms. Hence, it is difficult to evaluate performance of not-for-profit organisations using financial measures.

**Benefits may accrue over a longer term**

The expenditure incurred in one year may yield benefits over several years. A hospital may invest in creating ICU (Intensive Care Units) facility, the benefit of which will be obtained over multiple years. Such benefits cannot be measured reliably.

**Measurement of utilisation of funds & expenditure**

Some not-for-profit organisation spend out of their fixed budget and do not earn any revenue. The assessment of whether the spending have been appropriate is a key challenge. The organisations may resort to rampant spending simply to meet the expenditure targets. Many organisations get additional funds if they achieve the expenditure targets and this could be a motive for increase spending.

**Multiple objectives**

Many not-for-profit organisations are formed for multiple objectives. The prioritisation of objectives can be a challenging task.
Performance Measurement

Despite the challenges highlighted above, it is imperative that the performance measurement is carried out for not-for-profit organisations. This helps the members, donors and other stakeholders to get a comfort that the organisation is working towards desired objectives and mission.

Value for Money (VFM) Framework

A framework which can be used for measurement of performance in not-for-profit sector is the Value for Money framework. Not-for-profit organisations are expected to provide value for money which is demonstrated by:

- **Effectiveness**: Whether the organisation has achieved its desired mission and objectives?
- **Efficiency**: Whether the resources and funds available to the organisation has been utilised efficiently i.e, maximum output has been obtained with minimum input?
- **Economy**: Whether the desired output has been obtained using the lowest cost? It must be noted that use of lowest cost approach should not compromise quality.

**Example**

<table>
<thead>
<tr>
<th>Charitable School</th>
</tr>
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<tbody>
<tr>
<td>Let’s consider a case of a school which provides free education to children who come from BPL (below the property line) families. The school also provides free lunch to the students to encourage daily attendance.</td>
</tr>
<tr>
<td>A measure of effectiveness is whether the school has been able to provide quality education to desired number of students. The performance of the school can be measured using the metrics of number of students dropping out of school year-on-year. Another measure of performance could be the number of students who have successfully completely the 12th exams and joined college. It is important to note that the measures might not be wholly within the control of the school. A student might drop out even after best efforts by the school. This makes the performance measurement a challenging task.</td>
</tr>
</tbody>
</table>
A measure of **efficiency** could be the number of students trained per hour spent by teachers or the students to teacher ratio. In case of schooling a lower student to teacher ratio is always preferred.

A measure of **economy** would be the amount spent on maintaining the school premises, amount spent on remuneration to teachers etc. The amount spent can be compared against the budgeted expenditure or sanction amount.

If performance is measured based on cost incurred, the school might as well decide to cut necessary expenditure to meet the expenditure budget. For example, the school might not spend adequate amount to upkeep the library or computer equipments. This can be detrimental in the longer run. Hence, it is important to balance the financial measures with non-financial measures.

**Adapted Balanced Scorecard**

Kaplan developed the ‘Adapted Balanced Scorecard’ for measuring performance at NGOs. The main assumption of this adapted scorecard is that mission statement and not profits is the main point to be met. The following four perspectives are suggested in the adapted balanced scorecard:
It is important to note that the positioning of financial perspective and customer perspective is switched. This is due to the fact that achieving financial success is not the primary objective for these organisations. Instead, nonprofit organisations should be primarily concerned with how efficiently and effectively they meet the needs of their beneficiaries and donors/members.

Other Performance Measures

- The ability to raise funds to meet the objectives efficiently.
- Submitting periodic reports to the stakeholders in a transparent manner.
- The best use of financial as well as non-financial resources to achieve desired objectives and mission.
- The long-term impact (benefits) of the activities of the not-for-profit organisations.
- The quality of services provided by the organisations.

Performance Measurement Process

The performance measurement process typically starts with identification of the overriding objectives and mission of the not-for-profit organisation. This includes evaluating the mission, vision and strategy on a continuous basis. This stage typically defines the problem being solved and the stakeholder which would be addressed by the organisation. The various objectives/mission of the organisation are broken down and mapped with key strategies: Stakeholder (Customer), Financial, Internal Process and Learning & Growth. In other words, the objectives are mapped with various perspectives of the balanced scorecard. The performance measures/key performance indicators of each of the perspectives is defined. The actual outcome is measured and evaluated against the performance measures defined. Any changes which are required to the performance measures are carried out after analysis of the outcome on a periodic basis.

Performance Reports

Responsibility Accounting is implemented by issuing performance reports at frequent intervals that inform responsibility centre managers of the deviations from budgets for which they are countable and required to take action. Performance reports are useful for not only comparing budgeted results to actual results, but for also showing managers the effects of activity changes and how well these changes are controlled by management. Note that the reports start from the bottom and move upward with each manager receiving information on the operations of the unit for which he is directly responsible and summary information on performance of other lower level managers under their direct or indirect control. No matter how much authority and autonomy is given to responsibility managers, performance reports are needed to evaluate the performance of the managers at all operating levels of the organization. At bottom levels, it helps in determining what all corrective measures are required in their segments. At top management level, these reports keep them top managers informed on the performance of all segments.
SUMMARY

- Responsibility Accounting is the collection, summarization, and reporting of financial information where individual managers are held accountable for certain costs, revenue or assets of the firm.

- Linking CSFs to KPIs and Corporate Strategy –
  - Critical Success factors – Critical Success Factors are elements tied to the strategy of business and they represent objectives that businesses are trying to achieve, as a corporation, as a department, or as a business unit.
  - Key Performance Indicators are a consequence of critical success factors – they represent the ‘how’. Having outlined ‘what’ businesses want to achieve, a company must subsequently define sets of measures and associated targets in such a way that achieving those targets will translate into successful completion of a CSF.
  - Each critical success factor should have a KPI associated with it. A single Critical Factor can also have more than one KPI, if need be. The objectives, CSFs, and KPIs together represent a chain of links that together deliver a company’s strategic goal, by breaking down that strategic vision into a set of quantifiable targets.

- Pure financial performance measures are Return on Investment, Residual Income, Residual Income, Economic Value Added and Shareholder Value Added.

- Triple Bottom Line (TBL) – TBL expands traditional accountancy reporting systems, looking at social and environmental performance, rather than simply financial performance.

- Non – Financial Performance Measures like quality, reliability, flexibility, etc. are also required to be measured to access the success of any department or organisation apart from costs, revenues and profits.

- Integration of Financial and Non-Financial Measures –
  - Balanced Scorecard – Balanced Score Card is a set of financial and non-financial measures relating to a company’s critical success factors. It is an approach which provides information to management to assist in strategic policy formulation and achievement. It emphasizes the need to provide the user with a set of information which addresses all relevant areas of performance in an objective and unbiased manner. As a management tool, it helps companies to assess overall performance, improve operational processes and enable management to develop better plans for improvements. It offers managers a balanced view of their organization upon which they can base real change.

- Advantages of Balanced Scorecard – Management’s focus on strategy and vision, single management report, comprehensive picture of business operations, easy communication of organisational goals, provides strategic feedback and learning.

- Major Components of Balanced scorecard – Customer Perspective i.e how do customers see us, Internal Perspective i.e. what must we excel at, Innovation and Learning Perspective i.e. can we continue to improve and create value, Financial Perspective i.e. how do we look to our shareholders.
Process of Creating a Balanced Scorecard – Identify Vision i.e. where an organisation is going, Identify Strategies i.e. how an organisation is planning to go there, Identify CSFs and Perspectives i.e. what we have to do well in each perspective, Identify Measures which will ensure that everything is going in the expected way, Evaluate i.e. ensuring what we are measuring is right, Create Action Plan, Follow up and Manage i.e. what should be the structure of the reports and who should have the authority to look at it.

Performance Pyramid – The Performance Pyramid is also known as Strategic Measurement and Reporting Technique. They view businesses as performance pyramids. The attractiveness of this framework is that it links the business strategy with day-to-day operations.

Benefits of Performance Pyramid – Develops agreed measures, clarifies the objectives of the organisation, greater understanding of processes, helps in comparison between departments, promotes accountability to stakeholders, helps in setting targets, measures the effectiveness of the organisation.

Problems Performance Pyramid – Tunnel Vision i.e. undue focus on measurements, Sub-Optimisation i.e. focus on one measurement, Myopia i.e. focus on short term measures, Misrepresentation of Data, Misinterpretation of Data, Ossification i.e. representing outdated data.

Building Block Model – Fitzgerald and Moon have developed an approach to performance measurement in business services that is based on the three building blocks of dimensions, standards and rewards.

Dimensions are the goals, i.e. the CSFs for the business and suitable measures must be developed to measure each performance dimension and include Competitiveness, Financial Performance, Quality of Service, Flexibility, Resource Utilisation, Innovation. CSFs could be relative market share, in case of Competitiveness, turnover growth in case of Financial Performance, product reliability in case of Quality of Service, etc.

Standards Set, i.e. the KPIs, should have ownership, availability, awareness and Rewards should be motivating based on clarity of standards set and linked to controllable factors.

Advantages of building block model – All the key determinants of success are measured, Targets are set in such a way that staff are engaged and motivated.

Performance Prism – The Performance Prism is an approach to performance management which aims to effectively meet the needs and requirements of all stakeholders. This is in contrast with the performance pyramid which tends to concentrate on customers and shareholders and is also in contrast with value based management, which prioritizes the needs of shareholders.

Features – Starts with stakeholders rather than strategies of the organisation, recognises that stakeholder satisfaction is the key to organisation success.

Steps of Performance Prism – Focus on who are the stakeholders and what are the needs and wants of the stakeholders, plan the strategies required to fulfill the wants and needs of the stakeholders, identify the processes required for satisfying the above strategies, identify the capabilities for operating and enhancing the process and take into account what contribution does the management needs from its stakeholders.
Benefits of Performance Prism – Allows organisations to develop strategies, business processes and measures geared to the specific needs of all important stakeholder groups, enables an organisation to more directly address the risks and opportunities in its business environment, facilitates the communication and implementation of strategy relative to each stakeholder.

- Disadvantages to Non-financial Performance Measures – Multiple measures create conflict in the short term can also be time consuming, unlike accounting measures, non-financial data are measured in many ways, there is no common denominator.

- Benchmarking Schemes – Benchmarking is a technique for continuous improvement in performance. It involves comparing a firm’s products, services or activities against other best performing organisations, either internal or external to the firm. The objective is to find out how the product, service or activity can be improved and ensure that the improvements are implemented.
  - Types of Benchmarking – Competitive Benchmarking involves the comparison of competitors products, processes and business results with own, Strategic Benchmarking by examining the long term strategies, Global Benchmarking through which distinction in international culture, business processes and trade practices across companies are bridged and their ramification for business process improvement are understood and utilised, Process Benchmarking involves the comparison of an organisation critical business processes and operations against best practice organisation that performs similar work or deliver similar services, Functional Benchmarking look to benchmark with partners drawn from different business sectors or areas of activity to find ways of improving similar functions or work processes, Internal Benchmarking involves seeking partners from within the same organisation, for example, from business units located in different areas, External Benchmarking involves seeking help of outside organisations that are known to be best in class.

In intra group benchmarking the groups of companies in the same industry agree that similar units within the cooperating companies will pool data on their process. The processes are benchmarked against each other at or operational level. ‘Improvement task forces’ are established to identify and transfer best practice to all members of the group. In inter-industry benchmarking a non-competing business with similar process is identified and asked to participate in a benchmarking exercise.

- Goals of Benchmarking – Performance improvements and returns based on efficiency, cost savings and new revenues, effort to shift the culture of a company to be more customer oriented and results focussed.

- Process of Benchmarking – Planning, Collection of Data and Information, Analysing the Findings, Recommendations, Monitoring and Reviewing.

- Pre-requisites for Successful Benchmarking – Senior management support, clearly defined objectives, appropriate scope of work, availability of sufficient resources, clarity of organisation picture among the benchmarking teams, right skills and competencies of the benchmarking team, reasons for benchmarking are informed to all the stakeholders.
o Difficulties in implementation of Benchmarking – Time Consuming, delegation of authority not possible, resistance from employees, costly, non-identification of necessary improvements may result in wastage of time and resources.


- Performance Measurement in NFPs –
  o Value for money is interpreted as providing an economic, efficient and effective service (3 E’s).
  o Multiple and diverse objectives – NFP organisations are unlikely to have an objective of maximisation of shareholder wealth. Instead they are seeking to satisfy the particular needs of their members or sections of society, which they have been set up to benefit.