

Lecture	Topics
1	management accounting and risk classification
2	organization structure and silo effect
3	Financial metrics- ROI, RI, EVA
4	Internal Transfer Pricing
5	Performance metric and balanced scorecard
6	Mid Semester Test
7	Performance metric and balanced scorecard
8	Reward
9	Strategic Investment
10	Budget, Profit planning and market variance analysis

LECTURE 3 (Financial metrics- ROI, RI, EVA)

1st part of lecture 3 (Financial metrics)

Performance measurement's two aspects

- Quality of information as a measure of performance
 - Information quality attributes are relevance; faithful representation (complete, neutral, free of bias).
 - Enhancing characteristics are comparability, timeliness, verifiability, understandability, cost.
 - Information is used to inform strategic and operational decisions.
- Behavioural effects
 - Measurement tends to focus attention on the underlying performance attribute and influences the behaviour of the people involved.
 - The consequent behaviour may be intended or unintended.

Suitability of a performance metric

- Reflect strategy and key business drivers;
 - E.g. measure performance that relates to strategy. If strategy is to get more market share, your performance metric should NOT be how much waste has the company produced, but should be sales of company/sales of the whole industry.
 - How much wastage does not measure market share, but sales/sales of industry measures market share.
- Reflect managerial responsibility and accountability;
 - E.g. measure managers based on the control they have.
- Be responsive to managerial action – should not be unduly influenced by externalities, and should be sensitive to changes in the underlying performance attribute;
 - E.g. Measure production this year versus last year, however, there was a neighbour's construction for its building foundation this year that has caused our production to be damaged (externality)→ low production
 - Measurement has taken into account of something that is influenced by externalities. Low production is not because of the firm not performing well
- Have the intended behavioural effects - with no unintended consequences, and should not be susceptible to gaming or manipulation;
 - E.g. measurement of sales whether they are above a range.
 - Intended behaviour is that managers work hard to achieve the range
 - Unintended consequences- but this should not lead to manager faking their sales but creating false customers

- Try to come up with performance metrics that have less chances of leading to unintended consequences, but it's hard cause people usually find loopholes
- Faithfully represent what it purports to represent;
- Be comparable, timely, verifiable and understandable;
 - Comparable to other firms or to previous years
 - It is timely and so up to date
 - The performance measurement can be verified by someone else
 - The performance measurement can be understood by a reasonable person
- Be cost effective – the benefit of the measurement should exceed the associated costs of collecting data, generating reports, etc.
 - If calculating the performance metric cost more than benefits (help in decision making), then don't bother doing it.

* A performance metric rarely satisfies all the (above) desirable criteria. Trade-offs are inevitable.

* The relative importance of the attributes of a performance metric depends on the purpose of the measurement.

* Metrics suitable at one level of an organisation may not be suitable at another level. (metrics for CEO and managers can be different ; metrics for division A selling laptop and divisions B selling bottles can be different)

Diagnostic and interactive use of performance metrics

- We've learned this in week 2 (tutorial 2 task 1 - simons's framework for organisational control system)

Interactive use of performance metrics

- Interactive controls are when the company uses control system tools to interact with changes by continuously reconfiguring business strategy AND control system.
 - It requires significant communication between the top management AND unit managers, representing the action element of strategy.
 - We maybe fundamentally having the wrong strategy
 - E.g. Shift more from phones to laptops, but still not selling the laptops well. Maybe we have the wrong market place or wrong product to sell (wrong strategy) at the beginning
- Interactive control is used when there is a significant degree of uncertainty regarding the business strategy, objectives and targets, the management techniques or the suitability of the performance metrics.
 - Uncertainty of business strategy, needing us to reconfigure our business strategy.
- "Formal information systems that managers use to personally involve themselves in the decision activities of subordinates."
 - Managers need to make decision on whether or not to change strategy, objectives
- Key Element:
 - Require intensive use of management resources.
 - Senior managers are highly engaged.
 - Corrective action may involve changes to business strategy, objectives, management systems, the performance metrics used, etc.
 - Results are analysed in detail, additional information is gathered, assumptions and hypotheses are tested.