PERFORMANCE MEASURES DIVERSITY AND ITS' EFFECTS ON PERFORMANCE LEVEL

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ABSTRAK

Penilaian kinerja merupakan elemen yang penting dalam pengendalian manajemen. Hasil penilaian kinerja dapat digunakan untuk meningkatkan motivasi manajemen dan karyawan jika dibarengi dengan kebijakan reward and punishment yang jelas. Penilaian kinerja yang efektif seharusnya menggunakan alat ukur kinerja yang variatif. Berbagai ukuran kinerja dapat digunakan baik ukuran kinerja finansial, maupun non finansial, customized maupun standardized, ukuran yang bersifat objektif maupun subjektif, dan unique maupun common. Penggunaan ukuran kinerja yang majemuk dan bervariasi akan mendukung pencapaian level kinerja yang lebih baik ketimbang pemanfaatan satu jenis ukuran kinerja saja. Hal ini telah diuji dalam beberapa studi empiris yang dibahas dalam artikel ini.

Kata kunci: performance measurement, performance level, performance measures diversity

I. INTRODUCTION

Performance evaluation is an important element for managerial control and motivation. It plays a key role in translating an organization's strategy into desired behaviors and results (Van der Stede, et al, 2006; Gosh, 2005; Kaplan and Norton, 1996). A performance measurement system is simply a mechanism that improves the likelihood the organization will implement its strategy successfully (Anthony & Govindarajan, 2007).

To conduct a success performance measurement, it is crucial to consider some issues, as stated by Hitt, Black, and Porter (2005). First, whether there is a consensus among those involved about how

performance will be measured; secondly, whether the measurement criteria can be quantified; thirdly, whether all necessary aspects of actions contributing to performance are being measured; and finally, whether expensive, but non critical, controls can be eliminated.

Consensus can be attained by setting standard of performance. If specific and concrete standards have been set, there is more likely to be agreement on how performance is to be measured. However, when criteria are hard to quantify, it becomes important to gain as much consensus as possible about how performance is to be assessed. With the commitment agreed up-front, later complaints about what those measurements show and what they mean to individuals and the organization will be reduced.

Since performance in many jobs involves multiple activities, it is important for measurement to be comprehensive. If only some aspects of performance are measured, results can be misleading, and thus, they can skew the data that are used for taking action to improve performance (Hitt, Black, and Porter, 2005). This issue of performance measurement would be the core part of this article. It will be explored in some more details in the next sections.

The rest of the article is organized as follows. The next section discusses some theoretical reviews of performance measurement, followed by discussion on the issue of comprehensiveness of performance measurement, and concluded by a closing remark.

II. THEORITICAL AND CONCEPTUAL BACKGROUND

There are considerable amounts of literatures discussing performance measurement. Topics that are mostly cited include performance measurement and control system; performance measurement diversity; performance measurement and organization strategy; performance measurement and compensation policy, customized and standardized performance measurement, and so forth. Below is discussion of some of them.

Performance Measurement and Control System

The purpose of any performance measurement and control system is to communicate information. This system focuses on financial and non financial information that influence decision making process and actions of management. An organization creates numerous amount of information, although not all are relevant to managers in their work. For examples a profit and loss statement is important for managers' control system, but information received by a warehouse clerk about inventory for specific customers is not.

As a system, performance measurement assists managers in tracking the implementation of business strategy by comparing actual results against strategic goals and objectives (Simons, 2000). A performance measurement system typically comprises systematic methods of setting business goals together with periodic feedback reports that indicate progress against those goals. The goals can be short-term (normally one year) or long-term (more than one year).

There are two decisions that must be made when designing performance measurement system. Firstly, is about design features: what types of information should be collected and how frequent the feedbacks are to be made. Secondly, is about how to use the system: who should receive the data and what they should or should not do with the data. These decisions should be made based on the needs of organizations and sources availability.

Performance Measurement Diversity

To measure performances of organizations or business units, various techniques are available. The techniques can be classified into financial or non financial measures. Traditional approaches of performance measurement have emphasized the use of financial measures to conclude a business unit performance, while the more contemporary approaches tend to also consider non financial measures.

The contemporary methods believe that the solely use of financial measures is not enough in the new business environment in which more competitive situation happened. The present business environment is signed by the increase of customization, flexibility, responsiveness, and associated advances in manufacturing practices. Non financial performance measures are needed to support financial performance (Kaplan & Norton, 2001; Van der Stede et al, 2006). Table 1 below shows examples of financial and non financial measures frequently used in performance evaluation.

Table 1 Examples of Financial and Non Financial Measures

	Input Measures	Process Measures	Output Measures
Financial Measures for:			
a. New Products	Labor and material $	$ cost of prototyping	% of sales $ from new products
b. Order Processing	Clerical labor $	$ cost of backorder handling	$ cost per order processed
c. Parts Manufacture	$ Cost of component	Setup $ cost, cost of rework	$ cost per unit
Non Financial Measures for:			
a. New Products	# of engineering hours	# of product delivery milestone achieved	# of new products introduced
b. Order Processing	# of telephone answering staff	Order completion time	# of orders processed
c. Parts Manufacture	# of components meeting specification	Setup time	% of units meeting standard

Source: Simons, 2000, p.60.

Furthermore, a number of authors have argued that broadening the set of performance measures would enhance organizational performance because managers have an incentive to concentrate on activities for which their performance is measured and this happened often by sacrificing relevant but non measured activities (Hopwood, 1974, as stated in Van der Stede, 2006). Another study by Baiman and Rajan (1995) also identified the potential benefit of subjective performance measures, such as mitigating distortions in managerial effort by canceling dysfunctional behavior induced by objective performance measures. In addition, subjective performance measures also reduce noise in the overall performance evaluation in that they are influenced by uncertain, uncontrollable events.

Another choice of performance measurements includes customized and standardized performance measurement. The use of customized non traditional performance measures has increased recently, although the application of standardized measures still gains considerable attentions from companies. Customized measures, like customer satisfaction surveys and quality indices, may more accurately target the goals of each business unit; while a standardized set of measures may offer more meaningful opportunities for relative performance evaluation (Arya et al, 2005). Standardized measures naturally share common errors. This commonality in errors allows learning about one employee's measure from another and, thus, the construction of more efficient proxies for unobservable employee inputs. However, the use of comparative evaluation scheme is not without its challenges, since it may induce unwanted coordination by those being evaluated.

Performance Measurement and Compensation Policy

In terms of rewards system, all companies face the same important question: how to link their formal compensation system to the performance measurement. This is important to have higher motivated employees. If the employees are aware that their performance results will determine their compensation, then it is more likely that they do their job better. However, the problem here is not whether the company link performance to the compensation policy or

not. It is about *when* and *how* the connection should be made (Kaplan and Norton, 2001).

Organizations follow different strategies related to *when* and *how* they link the performance measurement results to compensation or promotion programs. Companies should do the link as soon as possible, which is from the formulation of objectives. Objectives must be measurable and rewards for achieving the objectives must be stated clearly in the compensation policy.

Rewards should be available not only for achieving financial objectives, but also non financial objectives. There is an increasing trend in the use of non financial measures in compensation contracts (HassabElnaby, et al, 2005). However, which measurements should be adopted must be carefully chosen. The choice between alternative performance measures varies by industry, indicating that these measures must be tailored to reflect industry-specific values and surrounding environments. Therefore, the adoption and retention of non financial measures is an endogenous choice with the potential net benefit depending on contextual factors. Organizations that align their performance measures with their firm characteristics tend to enhance their performance (Said et al, 2003 as stated in HassabElnaby, et al, 2005).

III. DISCUSSION

The main issue that must be discussed in this article is how performance measures diversity affects performance level. In this part, some empirical studies investigating this matter will be cited to provide evidences regarding the effect of the use of multiple performance measures on performance level of those being evaluated.

The first is a study conducted by Arya et al (2005). The study investigated the choice among performance measures with a focus on relative performance evaluation. They distinguished performance measures into customized and standardized ones. They found that there would be a trade off between customized and standardized measures when determining which to be chosen. Therefore the combined and balanced measures should be the best alternatives because customized performance measures may be able to reflect value more accurately, but in the same time diminish comparability across firms that are inherent in standardized measures.

Before a study by Arya et al (2005), Lipe and Salterio (2000) also compared the use of common versus unique measures. They stated that the common measures tend to be more traditional financial measures and tend to lag actual performance. Examples of common measures in financial perspective would be return on sales, sales growth, and return on assets. In contrast, unique measures that include sales of new stores, revenue per sales visit, and catalog profits, tend to be non traditional and more importantly, leading indicators of performance. The unique measures as the leading

indicators will capture elements of corporate and division strategic emphasis, thus it would be problematic to ignore them.

Common measures may dominate in comparative evaluations for at least three related reasons. First, they form a smaller subset of the total information, and it is cognitively easier to retain and process less, rather than more, information. Second, not only does this result in less total information, but also it may result in fewer categories or types of information to process (Lipe and Salterio 2002). Third, common measures are the only information available to directly compare the managers performances (Roberts, Albright, and Hibbets 2004).

Gosh (2005) is the next researcher who studied performance measures related to the outcome effect. One of the research purposes was to examine whether alternative performance evaluation measures of managers (like return on investment, sales per square foot, customer satisfaction, and employee satisfaction) with varying controllability increased or decreased the extent of the outcome effect. Controllability is the degree to which a specific manager's action influences the probability distribution of costs, revenues, or other items in question (Demski, 1994 as stated by Gosh, 2005). The participants were store manager and the task was set in a retail store. Analysis showed that non financial measures are commonly used in the retail organizations and important for managers' performance evaluation. The results revealed that (1) the outcome effect increased with the controllability of the manager's performance measure; (2)

outcome effect is greater for non financial measures than financial measures because of greater controllability of non financial measures. Again, this study has proved that there is a need to include non financial measures to evaluate managers' performance to give them more motivation.

The more recent research about performance measurement was conducted by Van der Stede et al. (2006). They studied about relationship between quality-based manufacturing strategy and the use of different types of performance measures, as well as their separate and joint effects on performance. Rather than just differentiated between financial and non financial measures, they went beyond by distinguishing between non financial measures that are quantitative and objectively derived (like defect rates), and those that are qualitative and subjectively determined (such as an assessment of the degree of cooperation or knowledge sharing across departmental borders).

As many as 128 manufacturing firms participated in the study. The study found that firms with more extensive performance measurement systems, especially ones that include objective and subjective non financial measures, have higher performance. The result remained the same regardless of the firm's manufacturing strategy. Thus their finding supports the view that performance measurement diversity, indeed beneficial. Furthermore they also found that among firms with similar strategies, those with less extensive performance measurement systems have lower performance,

whereas those with more extensive performance measurement systems do not. In the case of subjective performance measures, firms that use them more extensively than firms with similar quality-based strategies actually have significantly higher performance.

Having discussed the benefits of multiple performance measures, ones should aware that even though measurement should be comprehensive, not everything that possibly could be measured should be measured. Measurement has a cost, and the usefulness of the information obtained may not justify the cost. The issue here is one of criticality, that is, what is measured should be highly relevant to the goals of the organization. Activities that are necessary but do not provide relevant indicators of progress toward goals do not justify the expense to measure them. What is easy to measure may not be what is most important to control (Hitt, Black, and Porter, 2005).

IV. SUMMARY AND CONCLUSSION

Performance measurement is a crucial factor for managerial control. Results of the measurement could be used to increase managements' and employees' motivation when accompanied by a clear rewards and punishments policy. To become effective, a performance evaluation should be comprehensive and employ diversity measures, including financial and non financial measures, customized as well as standardized measures, unique or common measures, which are derived objectively or subjectively. The use of various measures at the same time would be able to increase

performance level of those being evaluated, because people have incentive to concentrate on activities for which their performance is measured. However, not everything is must be measured; only relevant aspects should be measured because measurement needs costs.

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