ACCA

Paper P5

Advanced Performance Management

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Paper Introduction
How to Use the Materials

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chances of success in your examinations.

The product range contains a number of features to help you in the study process. They include:

(1) Detailed study guide and syllabus objectives
(2) Description of the examination
(3) Study skills and revision guidance
(4) Complete text or essential text
(5) Question practice

The sections on the study guide, the syllabus objectives, the examination and study skills should all be read before you commence your studies. They are designed to familiarise you with the nature and content of the examination and give you tips on how to best to approach your learning.

The complete text or essential text comprises the main learning materials and gives guidance as to the importance of topics and where other related resources can be found. Each chapter includes:

- The learning objectives contained in each chapter, which have been carefully mapped to the examining body's own syllabus learning objectives or outcomes. You should use these to check you have a clear understanding of all the topics on which you might be assessed in the examination.
- The chapter diagram provides a visual reference for the content in the chapter, giving an overview of the topics and how they link together.
- The content for each topic area commences with a brief explanation or definition to put the topic into context before covering the topic in detail. You should follow your studying of the content with a review of the illustration/s. These are worked examples which will help you to understand better how to apply the content for the topic.
- Test your understanding sections provide an opportunity to assess your understanding of the key topics by applying what you have learned to short questions. Answers can be found at the back of each chapter.
• **Summary diagrams** complete each chapter to show the important links between topics and the overall content of the paper. These diagrams should be used to check that you have covered and understood the core topics before moving on.

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Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

**Icon Explanations**

**Definition** – Key definitions that you will need to learn from the core content.

**Key Point** – Identifies topics that are key to success and are often examined.

**Expandable Text** – Expandable text provides you with additional information about a topic area and may help you gain a better understanding of the core content. Essential text users can access this additional content on-line (read it where you need further guidance or skip over when you are happy with the topic).

**Illustration** – Worked examples help you understand the core content better.

**Test Your Understanding** – Exercises for you to complete to ensure that you have understood the topics just learned.

Some of the test your understandings in this material are shorter or more straightforward than questions in the P5 exam. They are contained in the material for learning purposes and will help you to build your knowledge and confidence so that you are ready to tackle past exam questions during the revision phase.

**Tricky topic** – When reviewing these areas care should be taken and all illustrations and test your understanding exercises should be completed to ensure that the topic is understood.
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(1) On-line referenceware: reproduces your Complete or Essential Text on-line, giving you anytime, anywhere access.
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Ask your local customer services staff if you are not already a subscriber and wish to join.

Syllabus

Paper background

The aim of ACCA Paper P5, Advanced performance management, is to apply relevant knowledge and skills and to exercise professional judgement in selecting and applying strategic management accounting techniques in different business contexts, and to contribute to the evaluation of the performance of an organisation and its strategic development.

Objectives of the syllabus

• Use strategic planning and control models to plan and monitor organisational performance.
• Assess and identify relevant macro-economic, fiscal and market factors and key external influences on organisational performance.
• Identify and evaluate the design features of effective performance management information and monitoring systems.
• Apply appropriate strategic performance measurement techniques in evaluating and improving organisational performance.
• Advise clients and senior management on strategic business performance evaluation and on recognising vulnerability to corporate failure.
• Identify and assess the impact of current developments in management accounting and performance management on measuring, evaluating and improving organisational performance.
Core areas of the syllabus

- Strategic planning and control.
- External influences on organisational performance.
- Performance measurement systems and design.
- Strategic performance measurement.
- Performance evaluation and corporate failure.
- Current developments and emerging issues in performance management.

Syllabus objectives

We have reproduced the ACCA’s syllabus below, showing where the objectives are explored within this book. Within the chapters, we have broken down the extensive information found in the syllabus into easily digestible and relevant sections, called Content Objectives. These correspond to the objectives at the beginning of each chapter.

Syllabus learning objective | Chapter reference
--- | ---
A STRATEGIC PLANNING AND CONTROL | 1
1 Introduction to strategic management accounting | 1
(a) Explain the role of strategic performance management in strategic planning and control.[2] | 1
(b) Discuss the role of corporate planning in clarifying corporate objectives, making strategic decisions and checking progress towards the objectives.[2] | 1
(c) Compare planning and control between the strategic and operational levels within a business entity.[2] | 1
(d) Assess the use of strategic management accounting in the context of multinational companies.[3] | 1
(e) Discuss the scope for potential conflict between strategic business plans and short-term localised decisions.[2] | 1
(f) Evaluate how SWOT analysis may assist in the performance management process.[2] | 1
(g) Apply and evaluate the methods of benchmarking performance.[3] | 1
## 2 Performance management and control of the organisation

(a) Evaluate the strengths and weaknesses of alternative budgeting models and compare such techniques as fixed and flexible, rolling, activity based, zero based and incremental.[3]

(b) Assess how budgeting may differ in not-for-profit organisations from profit-seeking organisations.[3]

(c) Evaluate the impact to an organisation of a move to ‘beyond budgeting’. [3]

## 3 Changes in business structure and management accounting

(a) Identify and discuss the particular information needs of organisations adopting a functional, divisional or network form and the implications for performance management.[2]

(b) Assess the influence of Business Process Re-engineering on systems development and improvements in organisational performance.[3]

(c) Discuss the concept of business integration and the linkage between people, operations, strategy and technology.[2]

(d) Analyse the role that performance management systems play in business integration using models such as the value chain and McKinsey’s 7s’s.[3]

(e) Identify and discuss the required changes in management accounting systems as a consequence of empowering staff to manage sectors of a business.[3]

## 4 Effect of information technology (IT) on strategic management accounting

(a) Assess the changing accounting needs of modern service orientated businesses compared with the needs of the traditional manufacturing industry.[3]

(b) Discuss how IT systems provide the opportunity for instant access to management accounting data throughout the organisation and their potential impact on business performance.[2]

(c) Assess how IT systems facilitate the remote input of management accounting data in an acceptable format by non-finance specialists.[2]
(d) Explain how information systems provide instant access to previously unavailable data that can be used for benchmarking and control purposes and help improve business performance (for example the use of enterprise resource planning systems and data warehouses).[2]

(e) Assess the need for businesses to continually refine and develop their management accounting and information systems if they are to maintain or improve their performance in an increasingly competitive and global market.[3]

5 Other environmental and ethical issues

(a) Discuss the ways in which stakeholder groups operate and how they effect an organisation and its strategy formulation and implementation (e.g. using Mendelow's matrix).[2]

(b) Discuss the ethical issues that may impact on strategy formulation and business performance.[3]

(c) Discuss the ways in which stakeholder groups may influence business performance.[2]

B EXTERNAL INFLUENCES ON ORGANISATIONAL PERFORMANCE

1 Changing business environment

(a) Assess the continuing effectiveness of traditional management accounting techniques within a rapidly changing business environment.[3]

(b) Assess the impact of different risk appetites of stakeholders on performance management.[3]

(c) Evaluate how risk and uncertainty play an important role in long term strategic planning and decision-making that relies upon forecast and exogenous variables.[3]

(d) Apply different risk analysis techniques in assessing business performance such as maximin, maximax, minimax regret and expected values.[3]

2 Impact of external factors on strategy and performance

(a) Discuss the need to consider the environment in which an organisation is operating when assessing its performance using models such as PEST and Porter's 5 forces, including areas: [2]

   (i) political climate
   (ii) market conditions
   (iii) funding.
(b) Assess the impact of governmental regulations and policies on performance measurement techniques used and the performance levels achieved (for example, in the case of utility services and former state monopolies). [3]

C PERFORMANCE MEASUREMENT SYSTEMS AND DESIGN

1 Performance management information systems
   (a) Discuss, with reference to performance management, ways in which the information requirements of a management structure are affected by the features of the structure. [2]
   (b) Evaluate the compatibility of management accounting objectives and management accounting information systems. [3]
   (c) Discuss the integration of management accounting information within an overall information system, for example the use of enterprise resource planning systems. [2]
   (d) Evaluate whether the management information systems are lean and the value of the information that they provide. [3]
   (e) Highlight the ways in which contingent (internal and external) factors influence management accounting and its design and use. [3]
   (f) Evaluate how anticipated human behaviour will influence the design of a management accounting system. [3]
   (g) Assess the impact of responsibility accounting on information requirements. [3]

2 Sources of management information
   (a) Discuss the principal internal and external sources of management accounting information, their costs and limitations. [2]
   (b) Demonstrate how the information might be used in planning and controlling activities, e.g. benchmarking against similar activities. [2]
   (c) Discuss those factors that need to be considered when determining the capacity and development potential of a system. [2]
### 3 Recording and processing methods

(a) Demonstrate how the type of business entity will influence the recording and processing methods.\[2\]

(b) Discuss how IT developments, e.g. unified corporate databases, RFIDs and network technology, may influence management accounting systems.\[2\]

(c) Discuss the difficulties associated with recording and processing data of a qualitative nature.\[2\]

### 4 Management reports

(a) Evaluate the output reports of an information system in the light of \[3\]
   (i) best practice in presentation
   (ii) the objectives of the report/organisation
   (iii) the needs of the readers of the report; and
   (iv) avoiding the problem of information overload.

### D STRATEGIC PERFORMANCE MEASUREMENT

#### 1 Performance hierarchy

(a) Discuss how the purpose, structure and content of a mission statement impacts on business performance.\[2\]

(b) Discuss the ways in which high level corporate objectives are developed.\[2\]

(c) Identify strategic objectives and discuss how they may be incorporated into the business plan.\[2\]

(d) Discuss how strategic objectives are cascaded down the organisation via the formulation of subsidiary performance objectives.\[2\]

(e) Discuss social and ethical obligations that should be considered in the pursuit of corporate performance objectives.\[2\]

(f) Explain the performance ‘planning gap’ and evaluate alternative strategies to fill that gap.\[3\]

(g) Apply critical success factor analysis in developing performance metrics from business objectives.\[3\]

(h) Identify and discuss the characteristics of operational performance.\[2\]

(i) Discuss the relative significance of planning as against controlling activities at different levels in the performance hierarchy.\[3\]
2 Strategic performance measures in private sector

(a) Demonstrate why the primary objective of financial performance should be primarily concerned with the benefits to shareholders.[2]

(b) Justify the crucial objectives of survival and business growth.[3]

(c) Discuss the appropriateness of, and apply different measures of performance, including: [3]
   (i) Return on Capital Employed (ROCE)
   (ii) Return on Investment (ROI)
   (iii) Earnings Per Share (EPS)
   (iv) Earnings Before Interest, Tax and Depreciation Adjustment (EBITDA)
   (v) Residual Income (RI)
   (vi) Net Present Value (NPV)
   (vii) Internal Rate of Return and modified internal rate of return (IRR, MIRR)
   (viii) Economic Value Added (EVA™).

(d) Discuss why indicators of liquidity and gearing need to be considered in conjunction with profitability.[3]

(e) Compare and contrast short and long run financial performance and the resulting management issues.[3]

(f) Explore the traditional relationship between profits and share value with the long-term profit expectations of the stock market and recent financial performance of new technology/communications companies.[3]

(g) Assess the relative financial performance of the organisation compared to appropriate benchmarks.[3]

3 Divisional performance and transfer pricing issues

(a) Describe, compute and evaluate performance measures relevant in a divisionalised organisation structure including ROI, RI and Economic Value Added (EVA).[3]

(b) Discuss the need for separate measures in respect of managerial and divisional performance.[2]

(c) Discuss the circumstances in which a transfer pricing policy may be needed and discuss the necessary criteria for its design.[2]

(d) Demonstrate and evaluate the use of alternative bases for transfer pricing.[3]
(e) Explain and demonstrate issues that require consideration when setting transfer prices in multinational companies.\[2\]

4 Strategic performance measures in not-for-profit organisations

(a) Highlight and discuss the potential for diversity in objectives depending on organisation type.\[3\]

(b) Discuss the need to achieve objectives with limited funds that may not be controllable.\[2\]

(c) Identify and discuss ways in which performance may be judged in not-for-profit organisations.\[2\]

(d) Discuss the difficulties in measuring outputs when performance is not judged in terms of money or an easily quantifiable objective.\[2\]

(e) Discuss how the combination of politics and the desire to measure public sector performance may result in undesirable service outcomes.\[3\]

(f) Assess ‘value for money’ service provision as a measure of performance in not-for-profit organisations and the public sector \[3\]

5 Non-financial performance indicators

(a) Discuss the interaction of non-financial performance indicators with financial performance indicators.\[2\]

(b) Discuss the implications of the growing emphasis on non-financial performance indicators.\[3\]

(c) Discuss the significance of non-financial performance indicators in relation to employees.\[2\]

(d) Identify and discuss the significance of non-financial performance indicators in relation to product/service quality e.g. customer satisfaction reports, repeat business ratings, customer loyalty, access and availability.\[3\]

(e) Discuss the issues in interpreting data on qualitative issues.\[2\]

(f) Discuss the significance of brand awareness and company profile and their potential impact on business performance.\[3\]
6  The role of quality in management information and performance measurement systems

(a) Discuss and evaluate the application of Japanese management practices and management accounting techniques, including:

   (i) Kaizen costing,
   (ii) Target costing,
   (iii) Just-in-time, and
   (iv) Total Quality Management.[3]

(b) Discriminate between quality, quality assurance, quality control and quality management.[2]

(c) Assess the relationship of quality management to the performance management strategy of an organisation. [3]

(d) Advise on the structure and benefits of quality management systems and quality certification.[3]

(e) Justify the need and assess the characteristics of quality in management information systems.[3]

(f) Discuss and apply Six Sigma as a quality improvement method using tools such as DMAIC for implementation. [2]

7  Performance measurement and strategic Human Resource Management issues

(a) Explain how the effective recruitment, management and motivation of people is necessary for enabling strategic and operational success.[3]

(b) Discuss the judgemental and developmental roles of assessment and appraisal and their role in improving business performance.[3]

(c) Advise on the relationships of performance management to performance measurement (performance rating) and determine the implications of performance measurement to quality initiatives and process redesign.[3]

8  Performance measurement and the reward systems

(a) Explore the meaning and scope of reward systems.[2]

(b) Discuss and evaluate different methods of reward practice.[2]

(c) Explore the principles and difficulty of aligning reward practices with strategy.[2]
(d) Advise on the relationship of reward management to quality initiatives, process re-design and harnessing of e-business opportunities.[3]

(e) Assess the potential beneficial and adverse consequences of linking reward schemes to performance measurement, for example, how it can affect the risk appetite of employees.[3]

9 Other behaviour aspects of performance measurement

(a) Discuss the accountability issues that might arise from performance measurement systems.[3]

(b) Evaluate the ways in which performance measurement systems may send the wrong signals and result in undesirable business consequences.[3]

(c) Demonstrate how management style needs to be considered when designing an effective performance measurement system.[3]

E PERFORMANCE EVALUATION AND CORPORATE FAILURE

1 Alternative views of performance measurement and management

(a) Apply and evaluate the ‘balanced scorecard’ approach as a way in which to improve the range and linkage between performance measures.[3]

(b) Apply and evaluate the ‘performance pyramid’ as a way in which to link strategy and operations and performance.[3]

(c) Apply and evaluate the work of Fitzgerald and Moon that considers performance measurement in business services using building blocks for dimensions, standards and rewards.[3]

(d) Discuss and apply the Performance Prism.[2]

(e) Discuss and evaluate the application of activity-based management.[3]

(f) Evaluate and apply the value-based management approaches to performance management.[3]

2 Strategic performance issues in complex business structures

(a) Evaluate the use and the application of strategic models in assessing the business performance of an entity, such as Boston Consulting Group and Porter.[3]
(b) Discuss the problems encountered in planning, controlling and measuring performance levels, e.g. productivity, profitability, quality and service levels, in complex business structures.\[3\]

(c) Discuss the impact on performance management of the use of business models involving strategic alliances, joint ventures and complex chain structures.\[3\]

3 Predicting and preventing corporate failure

(a) Assess the potential likelihood for/of corporate failure utilising quantitative and qualitative performance measures and models (such as Z-scores and Argenti). \[3\]

(b) Assess and critique quantitative and qualitative corporate failure prediction models.\[3\]

(c) Identify and discuss performance improvement strategies that may be adopted in order to prevent corporate failure.\[3\]

(d) Discuss how long-term survival necessitates consideration of life-cycle issues.\[3\]

(e) Identify and discuss operational changes to performance management systems required to implement the performance improvement strategies.\[3\]

F CURRENT DEVELOPMENTS AND EMERGING ISSUES IN PERFORMANCE MANAGEMENT

1 Current developments in management accounting techniques

(a) Discuss the ways through which management accounting practitioners are made aware of new techniques and how they evaluate them.\[3\]

(b) Discuss, evaluate and apply environmental management accounting using for example lifecycle costing, input/output analysis and activity-based costing.\[3\]

(c) Discuss the use of benchmarking in public sector performance (league tables) and its effects on operational and strategic management and client behaviour.\[3\]

(d) Discuss the issues surrounding the use of targets in public sector organisations.\[3\]
2 Current issues and trends in performance management

(a) Assess the changing role of the management accountant in today’s business environment as outlined by Burns and Scapens.\[3\]

(b) Discuss contemporary issues in performance management.\[2\]

(c) Discuss how changing organisation’s structure, culture and strategy will influence the adoption of new performance measurement methods and techniques.\[3\]

(d) Explore the role of the management accountant in providing key performance information for integrated reporting to stakeholders.\[2\]

The superscript numbers in square brackets indicate the intellectual depth at which the subject area could be assessed within the examination. Level 1 (knowledge and comprehension) broadly equates with the Knowledge module, Level 2 (application and analysis) with the Skills module and Level 3 (synthesis and evaluation) to the Professional level. However, lower level skills can continue to be assessed as you progress through each module and level.

The Examination

Examination format

• The examination will be a three hour paper plus 15 minutes of reading and planning time.
• The examination is in two sections:

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<th>Section</th>
<th>Number of marks</th>
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<tr>
<td>A</td>
<td>50</td>
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<tr>
<td>B</td>
<td>50</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
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• There will be four professional marks available.
• The pass mark is 50%.
• Candidates will receive a present value table and an annuity table.
Paper-based examination tips

Spend the reading time reading the paper and planning your answers. You are allowed to annotate the question paper, so make use of this – e.g. highlighting key issues in the questions, planning calculations, brainstorming requirements – ensure that you understand the question. A key issue is to decide which questions you wish to attempt from section B – it is worth planning all three in outline before deciding.

**Divide the time** you spend on questions in proportion to the marks on offer.

One suggestion for this examination is to allocate 1 and 4/5ths minutes to each mark available, so a 10-mark requirement should be completed in approximately 18 minutes. A danger in P5 is that you spend too long on the calculation aspects and neglect the written elements, so allocate your time within questions as well as between them.

Stick to the question and tailor your answer to what you are asked. Pay particular attention to the verbs in the question.

Spend the last five minutes reading through your answers and making any additions or corrections.

If you get completely stuck with a question, leave space in your answer book and return to it later.

If you do not understand what a question is asking, state your assumptions. Even if you do not answer in precisely the way the examiner hoped, you should be given some credit, if your assumptions are reasonable.

You should do everything you can to make things easy for the marker. The marker will find it easier to identify the points you have made if your answers are legible.

**Essay questions**: Your essay should have a clear structure. It should contain a brief introduction, a main section and a conclusion. Be concise. It is better to write a little about a lot of different points than a great deal about one or two points.

**Computations**: It is essential to include all your workings in your answers. Many computational questions require the use of a standard format. Be sure you know these formats thoroughly before the exam and use the layouts that you see in the answers given in this book and in model answers.

**Scenario-based questions**: Most questions will contain a hypothetical scenario. To write a good case answer, first identify the area in which there is a problem, outline the main principles/theories you are going to use to answer the question, and then apply the principles/theories to the case. It is vital that you relate your answer to the specific circumstances given.
Reports, memos and other documents: some questions ask you to present your answer in the form of a report or a memo or other document. So use the correct format – there could be easy marks to gain here.

Study skills and revision guidance

This section aims to give guidance on how to study for your ACCA exams and to give ideas on how to improve your existing study techniques.

Preparing to study

Set your objectives

Before starting to study decide what you want to achieve - the type of pass you wish to obtain. This will decide the level of commitment and time you need to dedicate to your studies.

Devise a study plan

Determine which times of the week you will study.

Split these times into sessions of at least one hour for study of new material. Any shorter periods could be used for revision or practice.

Put the times you plan to study onto a study plan for the weeks from now until the exam and set yourself targets for each period of study - in your sessions make sure you cover the course, course assignments and revision.

If you are studying for more than one paper at a time, try to vary your subjects as this can help you to keep interested and see subjects as part of wider knowledge.

When working through your course, compare your progress with your plan and, if necessary, re-plan your work (perhaps including extra sessions) or, if you are ahead, do some extra revision/practice questions.

Effective studying

Active reading

You are not expected to learn the text by rote, rather, you must understand what you are reading and be able to use it to pass the exam and develop good practice. A good technique to use is SQ3Rs – Survey, Question, Read, Recall, Review:

(1) Survey the chapter – look at the headings and read the introduction, summary and objectives, so as to get an overview of what the chapter deals with.

(2) Question – whilst undertaking the survey, ask yourself the questions that you hope the chapter will answer for you.
(3) **Read** through the chapter thoroughly, answering the questions and making sure you can meet the objectives. Attempt the exercises and activities in the text, and work through all the examples.

(4) **Recall** – at the end of each section and at the end of the chapter, try to recall the main ideas of the section/chapter without referring to the text. This is best done after a short break of a couple of minutes after the reading stage.

(5) **Review** – check that your recall notes are correct.

You may also find it helpful to re-read the chapter to try to see the topic(s) it deals with as a whole.

**Note-taking**

Taking notes is a useful way of learning, but do not simply copy out the text. The notes must:

- be in your own words
- be concise
- cover the key points
- be well-organised
- be modified as you study further chapters in this text or in related ones.

Trying to summarise a chapter without referring to the text can be a useful way of determining which areas you know and which you don’t.

**Three ways of taking notes:**

**Summarise the key points of a chapter.**

**Make linear notes** – a list of headings, divided up with subheadings listing the key points. If you use linear notes, you can use different colours to highlight key points and keep topic areas together. Use plenty of space to make your notes easy to use.

**Try a diagrammatic form** – the most common of which is a mind-map. To make a mind-map, put the main heading in the centre of the paper and put a circle around it. Then draw short lines radiating from this to the main sub-headings, which again have circles around them. Then continue the process from the sub-headings to sub-sub-headings, advantages, disadvantages, etc.

**Highlighting and underlining**

You may find it useful to underline or highlight key points in your study text – but do be selective. You may also wish to make notes in the margins.
Revision

The best approach to revision is to revise the course as you work through it. Also try to leave four to six weeks before the exam for final revision. Make sure you cover the whole syllabus and pay special attention to those areas where your knowledge is weak. Here are some recommendations:

**Read through the text and your notes again** and condense your notes into key phrases. It may help to put key revision points onto index cards to look at when you have a few minutes to spare.

**Review any assignments** you have completed and look at where you lost marks – put more work into those areas where you were weak.

**Practise exam standard questions** under timed conditions. If you are short of time, list the points that you would cover in your answer and then read the model answer, but do try to complete at least a few questions under exam conditions.

Also practise producing answer plans and comparing them to the model answer.

If you are stuck on a topic find somebody (a tutor) to explain it to you.

**Read good newspapers and professional journals**, especially ACCA’s **Student Accountant** – this can give you an advantage in the exam.

Ensure you **know the structure of the exam** – how many questions and of what type you will be expected to answer. During your revision attempt all the different styles of questions you may be asked.

**Further reading**

You can find further reading and technical articles under the student section of ACCA’s website.
### Present value table

Present value of 1, i.e. \((1 + r)^{-n}\)

Where: 
- \(r\) = discount rate
- \(n\) = number of periods until payment

<table>
<thead>
<tr>
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Present value of an annuity of 1, i.e.

\[
\frac{1 - (1 + r)^{-n}}{r}
\]

Where  
- \( r \) = discount rate  
- \( n \) = number of periods

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Introduction to strategic management accounting

Chapter learning objectives

Upon completion of this chapter you will be able to:

• explain the role of strategic performance management in strategic planning and control
• assess the continuing effectiveness of traditional management accounting techniques within a rapidly changing business environment
• discuss the ways through which management accounting practitioners are made aware of new techniques and how they evaluate them
• assess the changing role of the management accountant in today’s business environment as outlined by Burns and Scapens
• explore the role of the management accountant in providing key performance information for integrated reporting to stakeholders.
• discuss the role of corporate planning in clarifying corporate objectives, making strategic decisions and checking progress towards the objectives
• compare planning and control at the strategic and operational levels within a business entity
• assess the use of strategic management accounting in the context of multinational companies
• discuss the scope for potential conflict between strategic business plans and short-term localised decisions
• evaluate how SWOT analysis may assist in the performance management process
• apply and evaluate the methods of benchmarking performance
• discuss how the purpose, structure and content of a mission statement impacts on business performance
• discuss the ways in which high-level corporate objectives are developed
• identify strategic objectives and discuss how they may be incorporated into the business plan
• discuss how strategic objectives are cascaded down the organisation via the formulation of subsidiary performance objectives
• explain the performance ‘planning gap’ and evaluate alternative strategies to fill the gap
• apply critical success factor analysis in developing performance metrics from business objectives
• identify and discuss the characteristics of operational performance
• discuss the relative significance of planning against controlling activities at different levels of the performance hierarchy
• evaluate the use and application of strategic models in assessing the business performance of an entity, such as Boston Consulting Group and Porter
• discuss contemporary issues in performance management
• discuss how changing organisation’s structure, culture and strategy will influence the adoption of new performance measurement methods and techniques.
1 Introduction to Paper P5

Paper P5 will require you to assess different approaches to performance management from a variety of perspectives. This will require you to know what the approaches are and, more importantly, you should be able to compare one with another.

Performance management systems are the systems within the organisation by which the performance of the organisation is measured, controlled and improved.

2 Assumed knowledge

Paper P5 builds on knowledge gained at other levels, specifically Paper F5 and, to a lesser extent, Paper P3.

Paper F5, Performance Management, tested your knowledge and application of core management accounting techniques. Paper P5 develops key aspects introduced at F5 level with a greater focus on linking the syllabus topics together and evaluation of the key topics and techniques. Therefore, you should not expect to be retested in a Paper F5 style but need to be aware that all F5 knowledge is assumed to be known.

In the same way, Paper P5 builds on knowledge from Paper P3 but it is important to draw a distinction between the two papers. You need to approach these common topics from a P5 perspective, i.e. how do they influence performance management and measurement.

Chapter 1 builds on the following knowledge from Paper P3:

- Strategy and strategic planning
- Critical success factors (CSFs) and key performance indicators (KPIs)
- Benchmarking
- SWOT
- Gap analysis
3 Introduction to Chapter 1

This chapter sets the scene to Part A of the syllabus, ‘strategic planning and control’. It introduces the process of strategic planning and control and some of the tools used, i.e. benchmarking and SWOT analysis. In Paper P5 you should be able to use strategic planning and control models to plan and monitor an organisation’s performance. The chapter also looks at the use of the strategic model, the BCG matrix, in assessing business performance.

It also explores the changing role of the management accountant (syllabus area B) and discusses contemporary issues and trends in performance management (Part F of the syllabus).

4 Introduction to Planning and Control

4.1 Definitions

Planning and control are fundamental aspects of performance management.

**Strategic planning** is concerned with:

- where an organisation wants to be (usually expressed in terms of its objectives) and
- how it will get there (strategies).

**Control** is concerned with monitoring the achievement of objectives and suggesting corrective action.

4.2 Planning and control at different levels within an organisation

Planning and control takes place at different levels within an organisation. The performance hierarchy operates in the following order:

(1) Mission
(2) Strategic (corporate) plans and objectives
(3) Tactical plans and objectives
(4) Operational plans and targets.

4.3 Mission

A **mission statement** outlines the broad direction that an organisation will follow and summarises the reasons and values that underlie that organisation.
A mission should be:

- succinct
- memorable
- enduring, i.e. the statement should not change unless the entity's mission changes
- a guide for employees to work towards the accomplishment of the mission
- addressed to a number of stakeholder groups, for example shareholders, employees and customers.

**Illustration 1 – Mission**

**Ben and Jerry's**

'Our mission is to make, distribute and sell the finest quality ice cream and euphoric concoctions with a continued commitment to incorporating wholesome, natural elements and promoting business practices that respect the earth and the environment'.

**Microsoft**

'To enable people and business throughout the world to realise their full potential'.

**The British Broadcasting Corporation (BBC)**

'Inform, educate and entertain'.

**Pepsi**

'Beat Coke'.

The mission forms a key part of the planning process and should enhance organisational performance:

- It acts as a source of inspiration and ideas for the organisation’s detailed plans and objectives.
- It can be used to assess the suitability of any proposed plans in terms of their fit with the organisation’s mission.
- It can impact the day to day workings of an organisation, guiding the organisational culture and business practices used.
Drucker concluded that a mission statement should address four fundamental questions.

- What is our business?
- What is valued by the customer?
- What will our business be?
- What should our business be?

**Required:**

What are the potential benefits and drawbacks to an organisation of setting a mission statement?

**The lifespan of a mission**

There are no set rules on how long a mission statement will be appropriate for an organisation. It should be reviewed periodically to ensure it still reflects the organisation’s environment.

If the market or key stakeholders have changed since the mission statement was written, then it may no longer be appropriate.

A change in the mission statement may result in **new performance measures** being established to monitor the achievement (or otherwise) of the new mission.

**4.4 Strategic, tactical and operational plans**

To enable an organisation to fulfil its mission, the mission must be translated into strategic, tactical and operational plans.

Each level should be consistent with the one above.

This process will involve moving from general broad aims to more specific objectives and ultimately to detailed targets.
In this chapter we will focus on strategic and operational plans.

**Comparing planning and control between strategic and operational levels**

**Strategic** planning

- Long-term
- Considers the whole organisation as well as individual departments/ divisions
- Considers the internal and external environment and all stakeholders

**Operational** planning

- Short-term
- Considers the use of assets and resources
- Does not tend to consider the whole organisation

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**Illustration 2 – Strategic planning**

Strategic planning is usually, but not always, concerned with the long-term. It raises the question of **which business shall we be in?** For example, a company specialising in production and sale of tobacco products may forecast a declining market for these products and may therefore decide to change its objectives to allow a progressive move into the leisure industry, which it considers to be expanding.

---

**Strategic and operational planning**

**Planning**

**Strategic** planning is characterised by the following:

- long-term
- considers the whole organisation as well as individual SBU
- matches the activities of an organisation to its external environment
- matches the activities of an organisation to its resource capability and specifies future resource requirements
- will be affected by the expectations and values of all stakeholders, not just shareholders
- its complexity distinguishes strategic management from other aspects of management in an organisation. There are several reasons for this including:
  - it involves a high degree of uncertainty
  - it is likely to require an integrated approach to management
  - it may involve major change in the organisation.
Quite apart from strategic planning, the management of an organisation has to undertake a regular series of decisions on matters that are purely operational and short-term in character. Such decisions:

- are usually based on a given set of assets and resources
- do not usually involve the scope of an organisation’s activities
- rarely involve major change in the organisation
- are unlikely to involve major elements of uncertainty and the techniques used to help make such decisions often seek to minimise the impact of any uncertainty
- use standard management accounting techniques such as cost-volume-profit analysis, limiting factor analysis and linear programming.

**Required:**

Is the activity of setting a profit-maximising selling price for a product a strategic or operational decision?

Give reasons for your answer.
The role of performance management in planning and control

Performance management is any activity that is designed to improve the organisation’s performance and ensure that its goals are met.

- Planning will take place first to establish an appropriate mission and objectives.
- Performance management techniques will then be used to ensure that the most appropriate strategy is defined and executed in order to achieve the organisation’s mission and objectives.
- Finally, performance management will aim to measure whether the mission and objectives are being achieved and to recommend any improvement strategies that are required.

Performance management aims to direct and support the performance of all employees and departments so that the organisation’s goals are achieved. Therefore, any performance management system should be linked to performance measures at different levels of the hierarchy. One model of performance management that helps to link the different levels of the hierarchy is the performance pyramid.

The performance pyramid derives from the idea that an organisation operates at different levels, each of which has a different focus. However, it is vital that these levels support each other. It translates objectives from the top down and measures from the bottom up, the aim being that these are co-ordinated and support each other (this will be explored in more detail in Chapter 11).

5 Strategic (corporate) planning

We are now going to explore in more detail the role of strategic planning in performance management.

5.1 What is strategy?

The core of a company’s strategy is about choosing:

- **where** to compete and
- **how** to compete.

It is a means to achieve **sustainable competitive advantage**.

In terms of performance management, the test of a good strategy is whether it enables an organisation to use its resources and competencies advantageously in the context of an ever changing environment.
Strategic (or corporate) planning involves formulating, evaluating and selecting strategies to enable the preparation of a long-term plan of action and to attain objectives.

### 5.2 Strategic analysis, choice and implementation (rational model)

This three stage model of strategic planning is a useful framework for seeing the ‘bigger picture’ of performance management (and should be very familiar to you).

- **Strategic analysis**
  - External analysis to identify opportunities and threats
  - Internal analysis to identify strengths and weaknesses
  - Stakeholder analysis to identify key objectives and to assess power and interest of different groups
  - Gap analysis to identify the difference between desired and expected performance.

- **Strategic choice**
  - Strategies are required to ‘close the gap’
  - Competitive strategy – for each business unit
  - Directions for growth – which markets/products should be invested in
  - Whether expansion should be achieved by organic growth, acquisition or some form of joint arrangement.

- **Strategic implementation**
  - Formulation of detailed plans and budgets
  - Target setting for KPIs
  - Monitoring and control.

Each of these areas will be explored in greater detail throughout the course. However, it is worth noting that although strategy is still included in this paper, the main thrust in P5 will be looking at where objectives come from, identifying critical success factors, choosing metrics and how to implement strategy. Theory will be secondary.

### 5.3 The role of strategic (corporate) planning in clarifying corporate objectives

Corporate objectives concern the business as a whole and focus on the desired performance and results that a business intends to achieve.

The first stage of the strategic planning process, strategic analysis, will generate a range of objectives, typically relating to:

- maximisation of shareholder wealth
- maximisation of sales
• growth
• survival
• research and development
• leadership
• quality of service
• contented workforce
• respect for the environment.

These need to be clarified in two respects:

• **conflicts need to be resolved**, e.g. profit versus environmental concerns
• to facilitate implementation and control, objectives need to be translated into SMART (specific, measurable, achievable, relevant and time bound) targets.

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<th>Illustration 3 – SMART objectives</th>
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<td>A statement such as ‘maximise profits’ would be of little use in corporate planning terms. The following would be far more helpful:</td>
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<tr>
<td>• achieve a growth in EPS of 5% pa over the coming ten-year period</td>
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<tr>
<td>• obtain a turnover of $10 million within six years</td>
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<tr>
<td>• launch at least two new products per year.</td>
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### 5.4 Role of Strategic (corporate) planning in making strategic choices

The viability of a strategic choice should be assessed using three criteria:

- **Suitability**
  - Does the strategy have a suitable strategic fit, i.e. does it build on strengths, take advantage of opportunities and will new products fit with existing ones?

- **Acceptability**
  - Is the strategy acceptable to the stakeholders of the organisation, both in terms of risk and return?

- **Feasibility**
  - Can the necessary resources and competencies be obtained? Can the organisation manage the process of strategic change?
5.5 The role of strategic (corporate) planning in checking towards the objectives set

It is not enough merely to make plans and implement them.

- The results of the plans have to be compared against stated objectives to assess the firm’s performance.
- Action can then be taken to remedy any shortfalls in performance.

Strategic (corporate) planning is not a once-in-every-ten-years activity, but an ongoing process which must react quickly to the changing circumstances of the firm and of the environment.

Diagram of strategic (corporate) planning activities

- **Senior management**
  - (a) defines objectives
  - (b) sets targets of performance
  - (c) formulates strategy

  Interpretation into detailed financial models

- **Budget**

- **Actual result**

  **Deviation from planned activity**

  **Analysis and interpretation**

  **Corrective action**
  - (a) modify targets
  - (b) review budgets
  - (c) operating decisions

  **(PLANNING)**

  **(CONTROL)**
Why do you think managers need to understand strategic (corporate) planning?

6 Objectives, critical success factors and key performance indicators

6.1 Introduction

Once an organisation has established its objectives, it needs to identify the key factors and processes that will enable it to achieve those objectives.

Critical success factors (CSFs) are the vital areas ‘where things must go right’ for the business in order for them to achieve their strategic objectives. The achievement of CSFs should allow the organisation to cope better than rivals with any changes in the competitive environment and to maximise performance.

Key performance indicators (KPIs) are the measures which indicate whether or not the CSFs are being achieved.

Illustration 4 – CSFs and KPIs

A parcel delivery service, such as DHL, may have an objective to increase revenue by 4% year on year. The business will establish CSFs and KPIs which are aligned to the achievement of this objective, for example:

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<th>CSF</th>
<th>KPI</th>
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<td>Speedy collection from customers after their request for a parcel to be delivered.</td>
<td>Collection from customers within 3 hours of receiving the orders, in any part of the country, for orders received before 2.30pm on a working day.</td>
</tr>
<tr>
<td>Rapid and reliable delivery.</td>
<td>Next day delivery for destinations within the UK or delivery within 2 days for destinations in Europe.</td>
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</table>
6.2 CSFs

The organisation will need to have in place the **core competences** that are required to achieve the CSFs, i.e. something that they are able to do that is difficult for competitors to follow.

There are **five prime sources** of CSFs:

1. **The structure of the industry** – CSFs will be determined by the characteristics of the industry itself, e.g. in the car industry ‘efficient dealer network organisation’ will be important whereas in the food processing industry ‘new product development’ will be important.

2. **Competitive strategy, industry position and geographic location**
   - Competitive strategies such as differentiation or cost leadership will impact CSFs.
   - Industry position, e.g. a small company’s CSFs may be driven by a major competitor’s strategy.
   - Geographical location will impact factors such as distribution costs and hence CSFs.

3. **Environmental factors** – factors such as increasing fuel costs can have an impact on the choice of CSFs.

4. **Temporary factors** – temporary internal factors may drive CSFs, e.g. a supermarket may have been forced to recall certain products due to contamination fears and may therefore generate a short term CSF of ensuring that such contamination does not happen again in the future.

5. **Functional managerial position** – the function will affect the CSFs, e.g. production managers will be concerned with product quality and cost control.

6.3 Classifying CSFs

- **Internal**
  - deal with issues within the manager’s control, e.g. inventory control

- **External**
  - relate to issues outside of a manager’s control, e.g. material prices

- **Monitoring**
  - used to continuously scrutinise current situations, e.g. actual performance versus budget

- **Building**
  - look into the future of the organisation and its development, e.g. the development or launch of a new product
The directors of Dream Ice Cream (DI), a successful ice cream producer, with a reputation as a quality supplier, have decided to enter the frozen yogurt market in its country of operation. It has set up a separate operation under the name of Dream Yogurt (DY). The following information is available:

• DY has recruited a management team but production staff will need to be recruited. There is some concern that there will not be staff available with the required knowledge of food production.
• DY has agreed to supply yogurts to Jacksons, a chain of supermarkets based in the home country. They have stipulated that delivery must take place within 24 hours of an order being sent.
• DY hopes to become a major national producer of frozen yogurts.
• DY produces four varieties of frozen yogurt at present; Mango Tango, Very Berry, Orange Burst and French Vanilla.

Required:

Explain five CSFs on which the directors must focus if DY is to achieve success in the marketplace.

(10 marks)

Student accountant article: visit the ACCA website, www.accaglobal.com, to review the article on ‘Defining managers’ information requirements’ from August 2006.

6.4 KPIs

KPIs are essential to the achievement of strategy since what gets measured gets done, i.e. things that are measured get done more often than things that are not measured.
In addition, KPIs should be SMART (specific, measurable, attainable, relevant and time-bound).

Care must be taken when choosing what to measure and report. An unbalanced set of indicators may be valid for fulfilling the short-term needs of the organisation but will not necessarily result in long-term success. The balanced scorecard approach will seek to address this and is discussed in Chapter 11.

**6.5 Past exam question**

Some of the test your understandings in this material are shorter or more straightforward than questions in the P5 exam. They are contained in the material for learning purposes and will help you to build your knowledge and confidence so that you are ready to tackle past exam questions during the revision phase.

However, it is useful to look at some past exam/exam standard questions right from the beginning of this course in order to understand how the areas covered may be tested in the real exam. You need to understand how to interpret the requirements, read and understand the scenario and plan and structure your answer. You may not be able to tackle the entire question at this point but you should read and learn from the answer.

**Note:** requirement (d) has been included for completeness but the areas tested have not been covered in the material as yet.
Film Productions Co (FP) is a small international company producing films for cinema release and also for sale on DVD or to television companies. FP deals with all areas of the production from casting, directing and managing the artists to negotiating distribution deals with cinema chains and TV channels. The industry is driven by the tastes of its films’ audience, which when accurately predicted can lead to high levels of profitability on a successful film.

The company’s stated mission is to ‘produce fantastic films that have mass appeal’. The company makes around $200 million of sales each year equally split between a share of cinema takings, DVD sales and TV rights. FP has released 32 films in the past five years. Each film costs an average of $18 million and takes 12 months to produce from initial commissioning through to the final version. Production control is important in order to hit certain key holiday periods for releasing films at the cinema or on DVD.

The company’s films have been moderately successful in winning industry awards although FP has never won any major award. Its aims have been primarily commercial with artistic considerations secondary.

The company uses a top-down approach to strategy development with objectives leading to critical success factors (CSFs) which must then be measured using performance indicators. Currently, the company has identified a number of critical success factors. The two most important of these are viewed as:

(i) improve audience satisfaction
(ii) strengthen profitability in operations

At the request of the board, the chief executive officer (CEO) has been reviewing this system in particular the role of CSFs. Generally, the CEO is worried that the ones chosen so far fail to capture all the factors affecting the business and wants to understand all possible sources for CSFs and what it means to categorise them into monitoring and building factors.

These CSFs will need to be measured and there must be systems in place to perform that role. The existing information system of the company is based on a fairly basic accounting package. However, the CEO has been considering greater investment in these systems and making more use of the company’s website in both driving forward the business’ links to its audience and in collecting data on them.

The CEO is planning a report to the board of Film Productions and has asked you to help by drafting certain sections of this report.
Required:

You are required to draft the sections of the CEO’s report answering the following questions:

(a) Explain the difference between the following two types of CSF: monitoring and building, using examples appropriate to FP.

(4 marks)

(b) Identify information that FP could use to set its CSFs and explain how it could be used giving two examples that would be appropriate to FP.

(6 marks)

(c) For each of the two critical success factors given in the question, identify two performance indicators (PIs) that could support measurement of their achievement and explain why each PI is relevant to the CSF.

(10 marks)

(d) Discuss the implications of your chosen PIs for the design and use of the company’s website, its management information system and its executive information system.

(9 marks)

2 professional marks will be awarded for appropriateness of style and structure of the answer.

(Total: 31 marks)

7 Long-term and short-term conflicts

Strategic planning is a long-term, top-down process. The decisions made can conflict with the short-term localised decisions:

• Divisional managers tend to be rewarded on the short-term results they achieve. Therefore, it will be difficult to motivate managers to achieve long-term strategic objectives.

• Divisional managers need to be able to take advantage of short-term unforeseen opportunities or avoid serious short-term crisis. Strict adherence to a strategy could limit their ability to do this.
The whole concept of strategic planning explored earlier in this chapter implies a certain top-down approach. Even in the era of divisional autonomy and employee empowerment it is difficult to imagine that a rigorous strategic planning regime could be associated with a bottom-up management culture. There is a potential for conflict here.

- The idea of divisional autonomy is that individual managers operate their business units as if they were independent businesses – seeking and exploiting local opportunities as they arise.
- Managers are rewarded in a manner which reflects the results they achieve.
- The pressures on management are for short-term results and ostensibly strategy is concerned with the long-term. Often it is difficult to motivate managers by setting long-term expectations.
- Long-term plans have to be set out in detail long before the period to which they apply. The rigidity of the long-term plan, particularly in regard to the rationing and scheduling of resources, may place the company in a position where it is unable to react to short-term unforeseen opportunities, or serious short-term crisis.
- Strict adherence to a strategy can limit flair and creativity. Operational managers may need to respond to local situations, avert trouble or improve a situation by quick action outside the strategy. If they then have to defend their actions against criticisms of acting ‘outside the plan’, irrespective of the resultant benefits, they are likely to become apathetic and indifferent.
- The adoption of corporate strategy requires a tacit acceptance by everyone that the interests of departments, activities and individuals are subordinate to the corporate interests. Department managers are required to consider the contribution to corporate profits or the reduction in corporate costs of any decision. They should not allow their decisions to be limited by short-term departmental parameters.
- It is only natural that local managers should seek personal advancement. A problem of strategic planning is identifying those areas where there may be a clash of interests and loyalties, and in assessing where an individual has allowed vested interests to dominate decisions.
**8 The changing role of the management accountant**

**8.1 What is strategic management accounting?**

Strategic management accounting is a form of management accounting which aims to provide information that is relevant to the process of strategic planning and control. The focus is on both external and internal information and non-financial as well as financial factors.

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The strategic management accountant plays a **key role in performance management** helping to determine the financial implications of an organisation’s activities and decisions and in ensuring that these activities are focused on shareholders’ needs for profit.
A company selling wooden garden furniture in northern Europe is facing a number of problems:

- demand is seasonal
- it is sometimes difficult to forecast demand as it varies with the weather – more is sold in hot summers than when it is cooler or wetter
- the market is becoming more fashion-conscious with shorter product life cycles
- there is a growth in the use of non-traditional materials such as plastics.

As a result the company finds itself with high inventory levels of some items of furniture which are not selling, and is unable to meet demand for others. A decision is needed on the future strategic direction and possible options which have been identified are to:

- use largely temporary staff to manufacture products on a seasonal basis in response to fluctuations in demand – however it has been identified that this could result in quality problems
- automate production to enable seasonal production with minimum labour-related problems
- concentrate on producing premium products which are smaller volume but high-priced and less dependent on fashion.

**Required:**

How could strategic management accounting help with the decision making?

### 8.2 Changes in the role of the management accountant

The role of the management accountant has changed as a result of environmental pressures. **Burns and Scapens** studied how the role has changed over the last 20 years.

- The role has changed focus from financial control to **business support** making the management accountant more of a generalist. Management accountants may now spend much of their time as internal consultants and although they still produce standardised reports, more time is spent analysing and interpreting information rather than preparing reports.
This new role has been called a **hybrid accountant** since the management accountant has a valuable combination of both accounting and operational/commercial knowledge.

Traditionally, it was thought that accountants needed to be independent from operational managers in order to allow them to objectively judge and report their accounting information to senior managers. However, today accountants do not necessarily work in a separate accounting department but may be fully integrated into other departments, thus playing a key part in the operations and decision making process of the department.

### Role of a management accountant

A scan of current job advertisements for management accountants would show that they are frequently being asked to:

- inform strategic decisions and formulate business strategies
- lead the organisation’s business risk management
- ensure the efficient use of financial and other resources
- advise on ways of improving business performance
- liaise with other managers to put the finance view in context
- train functional and business managers in budget management
- identify the implications of product and service changes
- work in cross-functional teams involved in strategic planning or new product development.

### 8.3 Driving forces for change

<table>
<thead>
<tr>
<th>Driving force</th>
<th>Explanation</th>
</tr>
</thead>
</table>
| Management structure   | • Head office has delegated much responsibility to the strategic business units thus reducing the involvement of management accountants in areas such as detailed budgeting.  
                          | • The management accountant may now provide a link between the operational reports, the financial consequences and the strategic outcomes desired by the board. |
**8.4 Benefits of the changes for performance management**

- From an organisation’s perspective, the accountant will be a guide to the strategic business unit manager to ensure that strategic goals are reflected in performance management.
- The management accountant will take a supporting role in assisting strategic business unit managers in getting the most from their management information system. This will entail the accountant understanding the needs of the particular manager and then working with them to extract valuable reports from the management information system.
- The management accountant can develop a range of performance measures to capture the different factors that will drive its success.

**8.5 Sources of information**

There are a number of sources of information for the management accountant who wants to learn about new techniques. For example:

- articles published in professional journals and the press
- studies published in specialised journals
- information provided by professional bodies
- networking and exchanging ideas
- seminars
- TV, radio, books and the Internet.
8.6 Role of the management accountant in providing information to stakeholders

Introduction

The demands placed on management accountants have grown in recognition of significant sustainability challenges.

These demands require a rich supply of information, capable of informing stakeholders of the financial and non-financial impact of the company’s decisions.

Conventional management accounting systems often failed to provide this information.

The triple bottom line

Whilst all businesses are used to monitoring their profit figures, there are also environmental and social aspects to consider in the longer term.

The triple bottom line focuses on economic, environmental and social areas of concern.

<table>
<thead>
<tr>
<th>Area of concern</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic performance</td>
<td>• The management accountant must monitor the financial performance of the organisation to ensure its continued prosperity and fulfilment of shareholders’ needs.</td>
</tr>
<tr>
<td>Environmental performance</td>
<td>• Improved environmental practices may include taking steps to reduce waste, increase recycling and use energy efficient equipment.</td>
</tr>
<tr>
<td></td>
<td>• The management accountant must monitor the costs and benefits of such actions to ensure that the needs of stakeholders are being met.</td>
</tr>
</tbody>
</table>
The management accountant has an important role in preparing sustainability reports and capturing non-financial information.

There is a growing trend for companies to issue sustainability reports, sometimes as part of traditional financial reports. The problem with this type of ‘add-on’ to the annual financial report is that it is very selective and may communicate only the good news for readers, ignoring or obscuring the bad.

**Integrated reporting**

To tackle the problem discussed above, a new approach is being recommended called integrated reporting.

With integrated reporting, instead of having environmental and social issues reported in a separate section of the annual report, or a standalone ‘sustainability’ report, the idea is that one report should capture the strategic and operational actions of management in its holistic approach to business and stakeholder ‘wellbeing’.

The management accountant must be able to collaborate with top management in the integration of financial wellbeing with community and stakeholder wellbeing.

Integrated reporting will bring statutory reporting closer to the management accountant and will make management accountants even more important in bridging the gap between stakeholders and the company’s reports.

The management accountant will be expected to produce information that:

- is a balance between quantitative and qualitative information
- links past, present and future performance
- considers the regulatory impacts on performance
- provides an analysis of factors that could impact in the future.

<table>
<thead>
<tr>
<th>Social performance</th>
<th>Many examples exist such as a contribution by a company to community projects.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Perhaps harder to measure than the economic and environmental aspects.</td>
</tr>
<tr>
<td></td>
<td>Many activities don’t have to cost the organisation much (for example, giving staff time off every year to volunteer for charitable causes) but can have far reaching social benefits.</td>
</tr>
<tr>
<td></td>
<td>The management accountant must monitor the costs and benefits (as above).</td>
</tr>
</tbody>
</table>
There is clearly a need for the profession to accept the challenge for being the mechanism for a new type of transparency and accountability; one that incorporates social and environmental impacts as well as economic ones.

The role of the management accountant in sustainability is as yet not well established. However, it is anticipated that over time, integrated reporting will become the corporate reporting norm. This will offer a productive and rewarding future, not only for the management accountant but for society as a whole.

**International Integrated Reporting Council (IIRC)**

The IIRC was formed in August 2010 and aims to create a globally accepted framework for a process that results in communication by an organisation about value creation over time. The IIRC seeks to secure the adoption of an Integrated Reporting Framework (an alternative to the recommendations by the GRI) by report preparers. The Framework sets out several guiding principles and content elements that have to be considered when preparing an integrated report.

<table>
<thead>
<tr>
<th>Illustration 5 – Guiding principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>There are <strong>seven</strong> guiding principles, as follows:</td>
</tr>
</tbody>
</table>

**Strategic focus and future orientation** – the report should provide and insight into the organisation’s strategy and how it relates to the organisation’s ability to create value in the short, medium and long term.

**Connectivity of information** – the report should show a holistic picture of the combination, inter-relatedness and dependencies between the factors that affect the organisation’s ability to create value over time.

**Stakeholder relationships** – the report should provide an insight into the nature and quality of the organisation’s relationships with its stakeholders.

**Materiality** – the report should disclose information about matters that substantively affect the organisation’s ability to create value.

**Conciseness** – the report should be concise and include relevant information only.

**Reliability and completeness** – the report should include all material matters, both positive and negative, in a balanced way and without material error.

**Consistency and comparability** – the report should be consistent and comparable over time.
There are eight content elements:

**Organisational overview and external environment** – what does the organisation do and what are the circumstances under which it operates?

**Governance** – how does the organisation’s governance structure support its ability to create value in the short, medium and long term?

**Business model** – what is the organisation’s business model?

**Risks and opportunities** – what are the risks and opportunities that affect the organisation’s ability to create value over the short, medium and long term and how is the organisation dealing with them?

**Strategy and resource allocation** – where does the organisation want to go and how does it intend to get there?

**Performance** – to what extent has the organisation achieved its strategic objectives for the period?

**Outlook** – what challenges and uncertainties is the organisation likely to encounter in pursuing its strategy and what are the implications for future performance?

**Basis of preparation and presentation** – how does the organisation determine what matters to include in the integrated report and are such matters quantified or evaluated?

**The Global Reporting Initiative (GRI)**

The most accepted framework for reporting sustainability is the GRI’s Sustainability Reporting Guidelines, the latest of which ‘G4’ – the fourth of the guidelines – was issued in May 2013. The G4 Guidelines consist of principles and disclosure items.

- The principles help to define report content, quality of the report and give guidance on how to set the report boundary.
- The disclosure items include disclosures on management of issues as well as performance indicators themselves.
Reporting principles and disclosures

Reporting principles

Reporting principles are essentially the required characteristics of the Report Content and the Report Quality. The Principles for Defining Report Content are given as:

- Stakeholder Inclusiveness
- Sustainability Context
- Materiality
- Completeness.

The Principles for Defining Report Quality are given as:

- Balance
- Comparability
- Accuracy
- Timeliness
- Clarity
- Reliability.

Standard Disclosures

Two types of disclosure are required:

General standard disclosures:

- Strategy and Analysis
- Organisational Profile
- Identified Material Aspects and Boundaries
- Stakeholder Engagement
- Report profile
- Governance
- Ethics and Integrity.

Specific Standard Disclosures

- Disclosures on Management's Approach
- Indicators.
The G4 guidelines encourage disclosure of various 'aspects' in the three categories: Economic, Environmental and Social.

<table>
<thead>
<tr>
<th>Illustration 7 – Categories and aspects in the G4 guidelines</th>
</tr>
</thead>
<tbody>
<tr>
<td>The aspects grouped by category are:</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Economic</strong></td>
</tr>
<tr>
<td>• Economic Performance</td>
</tr>
<tr>
<td>• Market Presence</td>
</tr>
<tr>
<td>• Indirect Economic Impacts</td>
</tr>
<tr>
<td>• Procurement Practices</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Environmental</strong></td>
</tr>
<tr>
<td>• Materials</td>
</tr>
<tr>
<td>• Energy</td>
</tr>
<tr>
<td>• Water</td>
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<tr>
<td>• Biodiversity</td>
</tr>
<tr>
<td>• Emissions</td>
</tr>
<tr>
<td>• Effluents and Waste</td>
</tr>
<tr>
<td>• Products and Services</td>
</tr>
<tr>
<td>• Compliance</td>
</tr>
<tr>
<td>• Transport</td>
</tr>
<tr>
<td>• Overall</td>
</tr>
<tr>
<td>• Supplier Environmental Assessment</td>
</tr>
<tr>
<td>• Environmental Grievance Mechanisms.</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Social</strong> – this category is split into four sub-categories, each with several aspects associated with it as follows:</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Labour Practices and Decent Work</strong></td>
</tr>
<tr>
<td>• Employment</td>
</tr>
<tr>
<td>• Labour/Management Relations</td>
</tr>
<tr>
<td>• Occupational Health and Safety</td>
</tr>
<tr>
<td>• Training and Education</td>
</tr>
<tr>
<td>• Diversity and Equal Opportunity</td>
</tr>
</tbody>
</table>
• Equal Remuneration for Men and Women
• Supplier Assessment for Labour Practices
• Labour Practices Grievance Mechanisms.

**Human rights**

• Investment
• Non-discrimination
• Freedom of Association and Collective Bargaining
• Child Labour
• Forced or Compulsory Labour
• Security Practices
• Indigenous Rights
• Assessment
• Supplier Human Rights Assessment
• Human Rights Grievance Mechanisms.

**Society**

• Local Communities
• Anti-corruption
• Public Policy
• Anti-competitive Behaviour
• Compliance
• Supplier Assessment for Impacts on Society
• Grievance Mechanisms for Impacts on Society.

**Product Responsibility**

• Customer Health and Safety
• Product and Service Labelling
• Market Communications
• Customer Privacy
• Compliance.
9 Strategic management accounting in multinational companies

In the previous section we looked at the role of the strategic management accountant. Here we look at their role in multinational companies.

A multinational company has subsidiaries or operations in a number of countries, e.g. it may acquire raw materials in one country, manufacture the product in a second country, sell its products in the third country and have its head office in its home country.

Typically, a multinational company takes the form of a central corporation with subsidiaries in each of the countries in which it operates. Well-known examples include Ford, Shell, Nestlé, General Motors, Toyota and Microsoft. By the early 1990s, 37,000 multinational companies with annual sales of $5.5 billion controlled about one-third of the world’s private sector assets. The advent of these multinationals is associated with the apparent globalisation of the world economy. Various factors have contributed to this development, but one factor is critical. Increases in the scale of technology (in terms of cost, risk and complexity) have rendered even the largest national markets too small to be meaningful economic units on a stand-alone basis. Companies must expand internationally to support the technological development that is needed to remain competitive in many fields.

The modern trend in international business seems to be away from the old multinational corporations and towards networks and alliances. Strategic planning for the latter is another issue altogether.

The strategic process in a multinational company must take account of certain special features which have financial implications. These include:

- process specialisation
- product specialisation
- economic risk
- political sensitivities
- administrative issues.
**Multinational strategic management accounting**

**Process specialisation.** There may be a cost advantage in locating certain types of activity in certain countries. For example, a labour intensive operation may be best placed in a low wage area. Many companies (and not just traditional multinationals) have recently relocated customer service desks and telephone call centres to India.

**Product specialisation.** In spite of globalisation and the concept of ‘world products’, particular countries have characteristic tastes that the multinational must cater to.

**Economic risk.** The economics of a multinational operation may be highly sensitive to issues such as exchange rate fluctuations.

**Political sensitivities.** The multinational company operates across state boundaries and must be acutely aware of associated risk factors.

**Administrative issues.** A multinational company will find that even its own internal transactions are vulnerable to exchange rate movements, currency exchange controls and the existence (or absence) of international tax treaties. For example, if a multinational domiciled in country A tries to repatriate profits earned by its subsidiary in country B then it may find that those profits are taxed twice – once in A and again in B.

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**Impact of exchange rates**

In the 1980s, many car manufacturers (Nissan, Toyota and Peugeot to name but three) built car assembly facilities in the UK to serve the whole of Europe – because the UK was perceived as a low-cost area. The UK’s non- adoption of the Euro and the appreciation of the pound in the late 1990s suddenly made the UK a high-cost area. For a time, the viability of several high-profile plants was brought into question.

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**Test your understanding 8**

**Required:**

A multinational company with subsidiaries in North America and Europe is considering launching its products in South America. As a management accountant supporting senior managers in making strategic decisions, what factors would you need to consider in your assessment of the options facing the company? How will these factors influence performance measurement/ management?
10 Tools used in strategic analysis

10.1 Benchmarking

**Benchmarking** is the process of identifying **best practice** in relation to the products (or services) and the processes by which those products (or services) are created and delivered. The objective of benchmarking is to understand and evaluate the current position of a business or organisation in relation to best practice and to identify areas and means of performance improvement.

**Types of benchmarking**

There are three basic types:

- **Internal**: this is where another function or department of the organisation is used as a benchmark. Can be straightforward but may lack innovative solutions due to there being no external focus.
- **Competitor**: uses a direct competitor in the same industry with the same or similar processes as the benchmark. The biggest problem will be obtaining information from the competitor.
- **Process or activity**: focuses on a similar process in another company which is not a direct competitor. Can prove easier to obtain information from a non-competitor and can still find innovative solutions.
Among the pioneers in the benchmarking ‘movement’ were Xerox, Motorola, IBM and AT&T. The best known is the Xerox Corporation.

Some years ago, Xerox confronted its own unsatisfactory performance in product warehousing and distribution. It did so by identifying the organisation it considered to be the very best at warehousing and distribution, in the hope that ‘best practices’ could be adapted from this model. The business judged to provide a model of best practice in this area was L L Bean, a catalogue merchant (i.e. it existed in an unrelated sector). Xerox approached Bean with a request that the two engage in a co-operative benchmarking project. The request was granted and the project yielded major insights in inventory arrangement and order processing, resulting in major gains for Xerox when these insights were adapted to its own operations.

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### Strategic, functional and operational benchmarks

Benchmarks could include the following:

**Strategic benchmarks**

- market share
- return on assets
- gross profit margin on sales.

**Functional benchmarks**

- % deliveries on time
- order costs per order
- order turnaround time
- average stockholding per order.

**Operational benchmarks**

These are at a level below functional benchmarks. They yield the reasons for a functional performance gap. An organisation has to understand the benchmarks at the operational level in order to identify the corrective actions needed to close the performance gap.
The benchmarking process

Step 1: Set objectives and determine which areas or functions to benchmark.

Step 2: Identify key performance indicators and drivers that will be measured during benchmarking.

Step 3: Select organisations/partners for benchmarking comparison.

Step 4: Measure performance of all organisations/partners involved in benchmarking using measures identified in step 2.

Step 5: Measure own performance and compare it to the benchmark. Identify gaps in performance.

Step 6: Specify actions required to close the gap.

Step 7: Implement and monitor actions.

Benchmarking and the strategic planning process

Benchmarking can be used in all three areas of the strategic planning process:

- **Strategic analysis** – a company’s mission may be to be ‘the premium provider of its products’ but without comparison through benchmarking how will they know if they are delivering premium products? In addition, a company’s position can be summarised in a SWOT analysis. Each of these factors can be identified through benchmarking and any gaps identified.
Benchmarking metrics

Once an organisation has decided which aspects of its performance should be benchmarked, it must then establish metrics for these, i.e. how can performance be measured? Some areas will be easy to measure (such as material used) whereas others will be more difficult (such as customer service).

**Strategic choice** – benchmarking can help in assessing generic strategy. For example, an organisation may compare its costs to the leading competitor. If the organisation cannot better or equal those results then cost leadership is an inappropriate strategy to pursue.

**Strategic implementation** – for example, budgetary targets should be benchmarked against other organisations to ensure that they are both challenging and attainable.

Illustration 10 – Benchmarking success at Kelloggs

Kelloggs' factories all use the same monitoring techniques, so it is possible to compare performance between sites, although there are always some things that are done differently.

They can interrogate this information to improve performance across every site. As things have improved, Kelloggs have also had to reassess their baseline figures and develop more sophisticated tools to monitor performance to ensure they continue to make progress.

They have seen a 20% increase in productivity in six years using this system.

**Benchmarking evaluation**

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Drawbacks</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Identifies gaps in performance and sets targets which are challenging but achievable.</td>
<td>• Best practice companies may be unwilling to share data.</td>
</tr>
<tr>
<td>• Can help in assessing its current strategic position (more on SWOT analysis in section 10.2).</td>
<td>• Lack of commitment by management and staff. Staff need to be reassured that their status, remuneration and working conditions will not suffer.</td>
</tr>
<tr>
<td>• A method for learning and applying best practices.</td>
<td>• Identifying best practice is difficult.</td>
</tr>
</tbody>
</table>
### Benefits

- Encourages continuous improvement.
- A method of learning from the success of others.
- Can help to assess generic strategy.
- Minimises complacency and self-satisfaction with your own performance and can provide an early warning of competitive disadvantage.

### Drawbacks

- Costly in terms of time and money.
- What is best today may not be so tomorrow.
- Differences, for example in accounting treatment, may make comparisons meaningless.
- Too much attention is paid to the aspects of performance that are measured as a result of the benchmarking exercise, to the detriment of the organisation's overall performance.

### Performance comparison with the competition

Comparative analysis can be usefully applied to any value activity which underpins the competitive strategy of an organisation, an industry or a nation.

To find out the level of investment in fixed assets of competitors, the business can use physical observation, information from trade press or trade association announcements, supplier press releases as well as their externally published financial statements, to build a clear picture of the relative scale, capacity, age and cost for each competitor.

The method of operating these assets, in terms of hours and shift patterns, can be established by observation, discussions with suppliers and customers or by asking existing or ex-employees of the particular competitor. If the method of operating can be ascertained it should enable a combination of internal personnel management and industrial engineering managers to work out the likely relative differences in labour costs. The rates of pay and conditions can generally be found with reference to nationally negotiated agreements, local and national press advertising for employees, trade and employment associations and recruitment consultants. When this cost is used alongside an intelligent assessment of how many employees would be needed by the competitor in each area, given their equipment and other resources, a good idea of the labour costs can be obtained.
Another difference which should be noted is the nature of the competitors’ costs as well as their relative levels. Where a competitor has a lower level of committed fixed costs, such as lower fixed labour costs due to a larger proportion of temporary workers, it may be able to respond more quickly to a downturn in demand by rapidly laying off the temporary staff. Equally, in a tight labour market and with rising sales, it may have to increase its pay levels to attract new workers.

In some industries, one part of the competitor analysis is surprisingly direct. Each new competitive product is purchased on a regular basis and then systematically taken apart, so that each component can be identified as well as the processes used to put the parts together. The respective areas of the business will then assess the costs associated with each element so that a complete product cost can be found for the competitive product.

A comparison of similar value activities between organisations is useful when the strategic context is taken into consideration. For example, a straight comparison of resource deployment between two competitive organisations may reveal quite different situations in the labour cost as a percentage of the total cost. The conclusions drawn from this, however, depend upon circumstances. If the firms are competing largely on the basis of price, then differentials in these costs could be crucial. In contrast, the additional use of labour by one organisation may be an essential support for the special services provided which differentiate that organisation from its competitors.

One danger of inter-firm analysis is that the company may overlook the fact that the whole industry is performing badly, and is losing out competitively to other countries with better resources or even other industries which can satisfy customers’ needs in different ways. Therefore, if an industry comparison is performed it should make some assessment of how the resource utilisation compares with other countries and industries. This can be done by obtaining a measurement of stock turnover or yield from raw materials.

Benchmarking against competitors involves the gathering of a range of information about them. For quoted companies financial information will generally be reasonably easy to obtain, from published accounts and the financial press. Some product information may be obtained by acquiring their products and examining them in detail to ascertain the components used and their construction (‘reverse engineering’). Literature will also be available, for example in the form of brochures and trade journals.
However, most non-financial information, concerning areas such as competitors’ processes, customer and supplier relationships and customer satisfaction will not be so readily available. To overcome this problem, benchmarking exercises are generally carried out with organisations taken from within the same group of companies (intragroup benchmarking) or from similar but non-competing industries (interindustry benchmarking).

**Question practice**

The following question is an exam standard and style question on benchmarking. Make sure that you take the time to attempt this question and to review the recommended answer.

**Test your understanding 9**

AV is a charitable organisation, the primary objective of which, is to meet the accommodation needs of persons within its locality.

In an attempt to improve its performance, AV’s directors have started to carry out a benchmarking exercise. They have identified a company called BW which is a profit seeking private provider of rented accommodation.

BW has provided some operational and financial data which is summarised below along with the most recent results for AV for the year ended 31 May 2014.

**Income and expenditure accounts for the year ended 31 May 2014 were as follows:**

<table>
<thead>
<tr>
<th></th>
<th>AV ($)</th>
<th>BW ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rents received</td>
<td>2,386,852</td>
<td>2,500,000</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff and management costs</td>
<td>450,000</td>
<td>620,000</td>
</tr>
<tr>
<td>Major repairs and planned maintenance</td>
<td>682,400</td>
<td>202,200</td>
</tr>
<tr>
<td>Day-to-day repairs</td>
<td>478,320</td>
<td>127,600</td>
</tr>
<tr>
<td>Sundry operating costs</td>
<td>305,500</td>
<td>235,000</td>
</tr>
<tr>
<td>Net interest payable and other similar charges</td>
<td>526,222</td>
<td>750,000</td>
</tr>
<tr>
<td>Total costs</td>
<td>2,442,442</td>
<td>1,934,800</td>
</tr>
<tr>
<td>Operating (deficit/surplus)</td>
<td>(55,590)</td>
<td>565,200</td>
</tr>
</tbody>
</table>
Operating information in respect of the year ended 31 May 2014 was as follows:

(1) Property and rental information:

<table>
<thead>
<tr>
<th>Property Type</th>
<th>AV - size of property</th>
<th>AV - number of properties</th>
<th>AV - rent payable per week ($)</th>
<th>BW - number of properties</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 bedroom</td>
<td>80</td>
<td>40</td>
<td></td>
<td>40</td>
</tr>
<tr>
<td>2 bedrooms</td>
<td>160</td>
<td>45</td>
<td></td>
<td>80</td>
</tr>
<tr>
<td>3 bedrooms</td>
<td>500</td>
<td>50</td>
<td></td>
<td>280</td>
</tr>
<tr>
<td>4 bedrooms</td>
<td>160</td>
<td>70</td>
<td></td>
<td>nil</td>
</tr>
</tbody>
</table>

AV had certain properties that were unoccupied during part of the year. The rents lost as a consequence of unoccupied properties amounted to $36,348. BW did not have any unoccupied properties at any point during the year.

(2) Staff salaries were payable as follows:

<table>
<thead>
<tr>
<th>Staff Type</th>
<th>AV - number of staff</th>
<th>AV - salary per staff member per year ($)</th>
<th>BW - number of staff</th>
<th>BW - salary per staff member per year ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>2</td>
<td>35,000</td>
<td>3</td>
<td>50,000</td>
</tr>
<tr>
<td>2</td>
<td>2</td>
<td>25,000</td>
<td>2</td>
<td>35,000</td>
</tr>
<tr>
<td>3</td>
<td>20,000</td>
<td></td>
<td>20</td>
<td>20,000</td>
</tr>
<tr>
<td>18</td>
<td>15,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(3) Planned maintenance and major repairs undertaken

<table>
<thead>
<tr>
<th>Nature of work</th>
<th>AV - number of properties</th>
<th>AV - cost per property ($)</th>
<th>BW - number of properties</th>
<th>BW - cost per property ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miscellaneous construction work</td>
<td>20</td>
<td>1,250</td>
<td>10</td>
<td>5,220</td>
</tr>
<tr>
<td>Fitted kitchen replacements (all are the same size)</td>
<td>90</td>
<td>2,610</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Heating upgrades/ replacements</td>
<td>15</td>
<td>1,500</td>
<td>25</td>
<td>6,000</td>
</tr>
<tr>
<td>Replacement sets of windows and doors for 3 bedroomed properties</td>
<td>100</td>
<td>4,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

All expenditure on planned maintenance and major repairs may be regarded as revenue expenditure.
(4) **Day-to-day repairs information:**

<table>
<thead>
<tr>
<th>Classification of repair</th>
<th>AV – number of repairs undertaken</th>
<th>AV – total cost ($)</th>
<th>BW – number of repairs undertaken</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emergency</td>
<td>960</td>
<td>134,400</td>
<td>320</td>
</tr>
<tr>
<td>Urgent</td>
<td>1,880</td>
<td>225,600</td>
<td>752</td>
</tr>
<tr>
<td>Non-urgent</td>
<td>1,020</td>
<td>118,320</td>
<td>204</td>
</tr>
</tbody>
</table>

Each repair undertaken by BW costs the same irrespective of classification of repair.

**Required:**

(a) Assess the progress of the benchmarking exercise to date, explaining the actions that have been undertaken and those that are still required.  

(8 marks)

(b) Evaluate, as far as possible, AV’s benchmarked position.  

(9 marks)

(c) Evaluate the benchmarking technique being used and discuss whether BW is a suitable benchmarking partner for AV to use.  

(8 marks)

**Student accountant article:** visit the ACCA website, [www.accaglobal.com](http://www.accaglobal.com) to review the article on ‘benchmarking’.

**10.2 SWOT analysis**

The purpose of **SWOT analysis** (corporate appraisal) is to provide a summarised analysis of the company's present situation in the market place. It can also be used to identify CSFs and KPIs.
Using a SWOT analysis

Once a SWOT analysis has been carried out strategies can be developed that:

- neutralise weaknesses or convert them into strengths.
- convert threats into opportunities.
- match strengths with opportunities – a strength is of little use without an opportunity.

Test your understanding 10

Required:

What types of strengths, weaknesses, opportunities and threats would a ‘no frills’ airline have?

SWOT analysis and performance management and measurement

SWOT analysis helps an organisation to understand its environment and its internal capacities and hence to evaluate the potential strategic options it could pursue in its quest to improve organisational performance and to close any performance gaps that exist.

It can also help an organisation to identify key aspects of performance (CSFs) that need measuring (through the establishment of KPIs).
Finally, it can help in determining the information needs of the business in relation to measuring and reporting on the KPIs set.

<table>
<thead>
<tr>
<th>Test your understanding 11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Envie Co owns a chain of retail clothing stores specialising in ladies’ designer fashion and accessories. Jane Smith, the original founder, has been pleasantly surprised by the continuing growth in the fashion industry during the last decade.</td>
</tr>
<tr>
<td>The company was established 12 years ago, originally with one store in the capital city. Jane’s design skills and entrepreneurial skills have been the driving force behind the expansion. Due to unique designs and good quality control, the business now has ten stores in various cities.</td>
</tr>
<tr>
<td>Each store has a shop manger that is completely responsible for managing the staff and stock levels within each store. They produce monthly reports on sales. Some stores are continually late in supplying their monthly figures.</td>
</tr>
<tr>
<td>Envie runs several analysis programmes to enable management information to be collated. The information typically provides statistical data on sales trends between categories of items and stores. The analysis and preparation of these reports are conducted in the marketing department. In some cases the information is out of date in terms of trends and variations.</td>
</tr>
<tr>
<td>As the business has developed Jane has used the service of a local IT company to implement and develop their systems. She now wants to invest in website development with the view of reaching global markets.</td>
</tr>
<tr>
<td><strong>Required:</strong></td>
</tr>
<tr>
<td>(a) Construct a SWOT analysis with reference to the proposal of website development.</td>
</tr>
<tr>
<td>(b) Explain how the use of SWOT analysis may be of assistance to Envie Co’s performance management and measurement process.</td>
</tr>
</tbody>
</table>

11 Gap analysis

**Gap analysis** is carried out as the final part of strategic analysis. It identifies the planning gap. This is the difference between the desired and the expected performance.

The planning gap is often measured in terms of demand but may also be reported in terms of earnings, return on capital employed etc.
The example below shows a gap for 'earnings'.

In the diagram showing the gap:

\( F_0 \) = initial forecast

\( F_1 \) = forecast adjusted for improvements in **internal efficiency**, e.g. internal cost savings through better use of resources or divestment of a loss-making business unit.

\( F_2 \) = forecast adjusted for **product-market expansion**. The expansion gap involves the development of a new product or market.

\( T \) = target. The gap between \( F_2 \) and the target represents the forecast adjusted for **product-market expansion**. The diversification gap involves the development of new products and markets.

Benchmarking and SWOT analysis can both be used to identify the gap and to help the organisation to identify strategies to address the gap.

**Illustration 11 – SWOT analysis and gap identification**

SWOT analysis would seek to identify:

- **Threats focusing on weaknesses** – This would have top priority and the company should seek to identify and consider possible solutions. This requires a defensive response of some kind and may well necessitate rapid change.

- **Threats focusing on strengths** – this requires a review of the supposed strength to ensure that it is still as strong as previously thought. Remember, what is good today, may not be so tomorrow.
• **Opportunity focusing on strengths** – this gives the organisation the chance to develop strategic competitive advantage in the marketplace. They should check the research and assess the strengths again.

• **Opportunity focusing on weakness** – this will require management to make a decision as to whether to change and pursue the opportunity or, alternatively, ignore the prospect and ensure resources are not wasted in this area in future. Usually substantial change will be required if the company is going to pursue the opportunity. The company should check that their internal competencies will allow them to exploit the opportunity.

### 12 Use of strategic models to assess business performance

- The Boston Consulting Group matrix was met in Paper P3 where it was used for strategic portfolio analysis.
- This framework can also be used to assess business performance and performance management issues of an entity.

The BCG matrix shows whether the firm has a balanced portfolio in terms of the products it offers and the market sectors it operates in.

The matrix is constructed using the following steps:

1. Divide the business into divisions/strategic business units or products
2. Allocate each of these to the matrix.
3. Assess the prospects of each division or product.
4. Develop strategies and targets for each division or product.

<table>
<thead>
<tr>
<th>High Market growth</th>
<th>Low Market growth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Star</strong></td>
<td><strong>Problem child</strong></td>
</tr>
<tr>
<td>• Large share of high-growth market.</td>
<td>• Small share of high-growth market.</td>
</tr>
<tr>
<td>• High reinvestment rate required to hold/build position.</td>
<td>• Large investment required to grow (so cash user).</td>
</tr>
<tr>
<td>• Moderate cash flow.</td>
<td>• Or divest.</td>
</tr>
<tr>
<td><strong>Cash cow</strong></td>
<td><strong>Dog</strong></td>
</tr>
<tr>
<td>• Large share of low-growth market.</td>
<td>• Small share of low-growth market.</td>
</tr>
<tr>
<td>• Cash generator.</td>
<td>• Moderate or negative cash flow.</td>
</tr>
<tr>
<td>• Strategy is minimal investment to keep the product going.</td>
<td>• Divest.</td>
</tr>
</tbody>
</table>

| High Relative market share | Low Relative market share |
If the relevant information is available, market growth and relative market share should be calculated as follows:

- **Market growth** = the % increase/decrease in annual market revenue

  **Note:** if market revenue is given for a number of successive years the average % increase/decrease in annual market revenue can be calculated as follows:

  $$1 + g = \sqrt[n]{\frac{\text{most recent market revenue}}{\text{earliest market revenue}}}$$

  where $g$ = the increase/decrease in annual market revenue as a decimal and

  $n$ = the number of periods of growth

  As a guide, 10% is often used as the dividing line between high and low growth. However, this is a general guide only – do refer to and use the information given in the scenario.

- **Relative market share** = division’s market share ÷ market leader’s share

  where divisional market share = divisional revenue ÷ market revenue

  A relative market share greater than 1 indicates that the division or product is the market leader. 1 is the dividing line between high and low relative market share.

---

### The BCG matrix

<table>
<thead>
<tr>
<th>Star</th>
<th>Problem Child</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Is the high investment being spent effectively?</td>
<td><strong>(1) Assuming the strategy is to invest</strong></td>
</tr>
<tr>
<td>• Is market share being gained, held or eroded?</td>
<td>– Is market share being gained?</td>
</tr>
<tr>
<td>• Is customer perception (e.g. brand, quality) improving?</td>
<td>– Effectiveness of advertising spend.</td>
</tr>
<tr>
<td>• Are customer CSFs changing as the market grows?</td>
<td><strong>(2) Assuming the strategy is to divest</strong></td>
</tr>
<tr>
<td>• What is the net cash flow?</td>
<td>– Monitor contribution to see whether to exit quickly or divest slowly.</td>
</tr>
<tr>
<td>• Is the star becoming a cash cow?</td>
<td></td>
</tr>
</tbody>
</table>

---

**KAPLAN PUBLISHING**
**Cash Cow**

- What is the net cash flow?
- Is market share being eroded – could the cash cow be moving towards becoming a dog?

**Dog**

- Monitor contribution to see whether to exit quickly or divest slowly.
- Monitor market growth as an increase in the growth rate could justify retaining the product.

---

**Test your understanding 12**

Food For Thought (FFT) has been established for over 20 years and has a wide range of food products. The company’s objective is the maximisation of shareholder wealth.

The organisation has four divisions:

1. Premier
2. Organic
3. Baby
4. Convenience.

The Premier division manufactures a range of very high quality food products, which are sold to a leading supermarket, with stores in every major city in the country. Due to the specialist nature of the ingredients these products have a very short life cycle.

FFT’s board have decided to perform a Boston Consulting Group (BCG) analysis to understand whether they have right mix of businesses.

The Organic division manufactures a narrow range of food products for a well-established Organic brand label.

The Baby division manufactures specialist foods for infants, which are sold to the largest UK Baby retail store.

The Convenience division manufactures low fat ready-made meals for the local council.
The following revenue data has been gathered:

**Year ending 31st March:**

<table>
<thead>
<tr>
<th>Division</th>
<th>Market size</th>
<th>Sales revenue</th>
<th>Market size</th>
<th>Sales revenue</th>
<th>Market size</th>
<th>Sales revenue</th>
<th>Market size</th>
<th>Sales revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premier</td>
<td>180</td>
<td>10</td>
<td>210</td>
<td>12</td>
<td>260</td>
<td>18</td>
<td>275</td>
<td>25</td>
</tr>
<tr>
<td>Organic</td>
<td>18.9</td>
<td>13.5</td>
<td>19.3</td>
<td>14</td>
<td>19.6</td>
<td>14.5</td>
<td>19.8</td>
<td>15</td>
</tr>
<tr>
<td>Baby</td>
<td>65</td>
<td>2.5</td>
<td>69</td>
<td>2.7</td>
<td>78</td>
<td>2.8</td>
<td>92</td>
<td>2.9</td>
</tr>
<tr>
<td>Convenience</td>
<td>26</td>
<td>0.9</td>
<td>27.2</td>
<td>0.9</td>
<td>27.6</td>
<td>0.92</td>
<td>28</td>
<td>0.94</td>
</tr>
</tbody>
</table>

The management accountant has also collected the following information for 20X7 for comparison purposes.

<table>
<thead>
<tr>
<th>Market leader</th>
<th>% share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premier</td>
<td>17%</td>
</tr>
<tr>
<td>Organic</td>
<td>78%</td>
</tr>
<tr>
<td>Baby</td>
<td>25%</td>
</tr>
<tr>
<td>Convenience</td>
<td>31%</td>
</tr>
</tbody>
</table>

Each of division’s performance is measured using EVA. The divisional manager’s remuneration package contains a bonus element which is based on the achievement of the division’s cost budget (this is set at board level).

**Required:**

Using the BCG matrix assess the competitive position of Food For Thought. Evaluate the divisional manager’s remuneration package in light of the divisional performance system and your BCG analysis.

**Where products stand within the BCG matrix**

The logical thrust here is that, if you enjoy a high market share, then you will probably have a strong position because of low unit production cost and a high market profile. A product that has a high growth potential offers obvious advantages but it is typically associated with high development costs because of the need to develop the product itself and/or maintain the high market share.
The nature of the four classifications shown above is self-explanatory. An understanding of where given products stand in relation to this matrix can be another essential element in strategic planning. For example, if a product is a cash cow, then it may be very useful, but it should be appreciated that it may be at an advanced stage in its life cycle and the cash it generates should be invested in potential stars.

However, it is not always easy to distinguish between a star and a dog. Many businesses have poured money into the development of products that they believed were potential stars only to find that those products turned into dogs. The Sinclair C5 (a small, battery-powered car) is often quoted as an example of this phenomenon. The promoters of this product in the 1980s proceeded on the basis that there was a market for such a car as a means of urban transport and that the C5 would enjoy a high share of this market. In fact, the only niche it found was as a children’s toy and it achieved only a low market share with little growth potential as such. The general point this model makes is that current period cash flow is not an unambiguous statement on the performance of a product or business sector. To appreciate fully the performance of a product, one has to appreciate where the product stands in terms of the above matrix. A poor current cash flow may be acceptable from a product or service considered to be a ‘Star’.

### Use of BCG analysis as a performance management tool

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Drawbacks</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Ensures that a balanced portfolio of products or divisions exists, i.e. are there enough cash cows to support our question marks and stars? Are there a minimum number of dogs?</td>
<td>• Too simplistic, e.g. a high market share does not always translate to competitive advantage. A strong brand, for example, may give competitive advantage despite a low market share.</td>
</tr>
<tr>
<td>• Can use to manage divisions in different ways, e.g. divisions in a mature market should focus on cost control and cash generation.</td>
<td>• Designed as a tool for product portfolio analysis rather than performance measurement.</td>
</tr>
<tr>
<td></td>
<td>• Downgrades traditional measures such as profit and so may not be aligned with shareholder's objectives.</td>
</tr>
</tbody>
</table>
13 Current issues and trends in performance management

13.1 Introduction

The area of performance management is constantly evolving. The techniques and systems used today are very different from those of 50 years ago and there are current issues and pressures which are likely to lead to further developments:

- changes in technology may have a significant impact on measuring performance
- a recognition that there is a broader picture than just financial performance
- issues relating to governance.

---

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Drawbacks</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Metrics used by the division can be in line with the analysis, e.g. metrics for high growth prospects may be based on profit and ROI and metrics for lower growth prospects will focus on margin and cash generation.</td>
<td>• Starting point for performance management only.</td>
</tr>
<tr>
<td>• Looks at the portfolio of divisions or products as a whole rather than assessing the performance of each one separately.</td>
<td>• Does not consider links between business units, e.g. a dog may be required to complete a product range.</td>
</tr>
<tr>
<td>• Can be used to assess performance, e.g. if an organisation consists mainly of cash cows we would expect to see static or low growth in revenue.</td>
<td></td>
</tr>
</tbody>
</table>
**Contemporary issues in performance management**

**Changes in technology**

Improvements in technology have a significant impact on performance management.

- It is possible to measure more and more different indicators of performance – the challenge now is to ensure that the aspects being measured and managed are the right ones.
- Improved technology also means that it is possible to produce information much more quickly and in real time.
- Information is now made directly available to managers on their desks at the touch of a button. The production of performance reports is no longer the responsibility of a small number of specialists – rather their role is to design the overall system to ensure that it provides the information required by managers.
- The availability of more data does not automatically mean that there is more useful information – it is still important to ensure that the data is interpreted to ensure that it is useful.
- Performance management is about more than the information produced – however much information is provided, what is important is how it is used and how the organisation acts in response to it.

**Broadening performance management**

There is a growing recognition that the performance of organisations depends on more than purely financial performance.

- There has been significant growth in the use of non-financial measures of performance.
- Techniques have been developed to enable measurement of performance in a number of different dimensions, and this trend looks set to continue. Examples are the balanced scorecard and the performance prism.
- Historically the focus of performance management has been on outputs of the organisation’s activities. Organisations are now beginning to focus on outcomes, or achievements, and then using output measures to achieve those outcomes.
- There is a recognition that everyone in the organisation needs to be involved in performance management.
Governance

Over recent years, the issue of corporate governance has become a major area for concern in many countries. Organisations are now under increased pressure to demonstrate that they are effectively managed. This has led to:

- pressure to demonstrate improvements in performance
- more demands for accountability from external agencies
- legislation and regulation relating to performance reporting
- companies looking for ways to measure and report on improvements in governance.

13.2 The influence of structure, culture and strategy

The way in which new techniques and methods are adopted will vary between organisations and will be influenced by organisational structure, culture and strategy.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Explanation</th>
</tr>
</thead>
</table>
| Organisational structure | • Highly centralised and/ or functional structures will tend to inhibit the manager’s discretion to try out new techniques.  
• A task centred and/ or decentralised structure will have the opposite effect. |
| Organisational culture   | • A restrictive, bureaucratic culture will be less open to the adoption of new techniques.  
• An innovative or creative culture will be a lot more willing to embrace new techniques. |
| Organisational strategy  | • The techniques adopted by an organisation will be influenced by the strategy it is pursuing.  
• For example, an organisation that focuses on quality may adopt a TQM approach whereas an organisation that focuses on cost reduction may adopt an activity-based approach. |
### 14 Exam focus

<table>
<thead>
<tr>
<th>Exam sitting</th>
<th>Area examined</th>
<th>Question number</th>
<th>Number of marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 2014</td>
<td>Benchmarking</td>
<td>1(iii)</td>
<td>16</td>
</tr>
<tr>
<td>June 2014</td>
<td>Mission</td>
<td>1 (v)</td>
<td>6</td>
</tr>
<tr>
<td>December 2013</td>
<td>KPIs, CSFs and gap analysis</td>
<td>1(i)(iii)(iv)(v)</td>
<td>35</td>
</tr>
<tr>
<td>December 2012</td>
<td>Changing role of management accountant</td>
<td>5(a)</td>
<td>12</td>
</tr>
<tr>
<td>June 2012</td>
<td>Benchmarking</td>
<td>4</td>
<td>17</td>
</tr>
<tr>
<td>June 2012</td>
<td>KPIs</td>
<td>2(a)</td>
<td>12</td>
</tr>
<tr>
<td>December 2011</td>
<td>KPIs</td>
<td>2(a)</td>
<td>7</td>
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<td>June 2011</td>
<td>BCG</td>
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<td>CSFs and KPIs</td>
<td>1 (a)–(c)</td>
<td>20</td>
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<tr>
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<td>KPIs</td>
<td>4(a)</td>
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<tr>
<td>December 2009</td>
<td>KPIs</td>
<td>2(b)(i)</td>
<td>12</td>
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<td>December 2009</td>
<td>Mission, CSFs and KPIs</td>
<td>5</td>
<td>17</td>
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<tr>
<td>December 2008</td>
<td>Planning gap</td>
<td>3(a)</td>
<td>5</td>
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<tr>
<td>June 2008</td>
<td>Benchmarking</td>
<td>1(b)</td>
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<td>December 2007</td>
<td>CSFs</td>
<td>3(b)</td>
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<tr>
<td>Pilot paper</td>
<td>Mission</td>
<td>2(a)(i)</td>
<td>5</td>
</tr>
</tbody>
</table>

**Note:**

- The current examiner has set the exam papers from the December 2010 sitting onwards.
- The format of the exam changed in June 2013. Section A now contains $1 \times 50$ mark question (previously 2 questions worth 60 marks in total) and Section B now contains a choice of 2 from 3 questions worth 25 marks each (previously a choice of 2 from 3 questions worth approximately 20 marks each).
Chapter summary

Planning and control
- definitions
- different levels
- mission
- strategic, tactical and operational plans

Strategic planning
- what is strategy?
- rational model
- role in competing objectives, making strategic choices and checking towards objectives set

Objectives, CSFs and KPIs
- definitions
- sources CSFs
- classifying CSFs
- KPIs

Long-term and short-term conflicts

Current issues and trends in performance management

Introduction to strategic management accounting

The changing role of the management accountant
- What is strategic management accounting?
- Changes in the role of the management accountant
- Driving forces for change
- Benefits of the changes for performance management
- Sources of information
- Role of management accountant in providing information to stakeholders

Strategic management accounting in multinational companies

Tools used in strategic analysis
- benchmarking
- SWOT analysis

Gap analysis

Strategic models to assess business performance
- BCG
Test your understanding answers

Test your understanding 1

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Drawbacks</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Provides strategic direction thereby assisting in the formation of acceptable strategies.</td>
<td>• They may be unclear or vague.</td>
</tr>
<tr>
<td>• Assists in resolving conflict between stakeholder groups.</td>
<td>• They may be unrealistic.</td>
</tr>
<tr>
<td>• Provides a framework within which managerial decisions can be made.</td>
<td>• There may be inconsistencies between the different elements of the mission statement.</td>
</tr>
<tr>
<td>• Assists in communicating key cultural values to employees and other stakeholders.</td>
<td>• They may be inconsistent with management action.</td>
</tr>
<tr>
<td>• Helps to prevent potential misinterpretations of the organisation's reason for being.</td>
<td>• They may lack sufficient external focus.</td>
</tr>
<tr>
<td></td>
<td>• It may be difficult to measure the achievement of the mission statement or appropriate performance measures may not be established to begin with.</td>
</tr>
</tbody>
</table>

Test your understanding 2

This is an operational decision. Setting a profit-maximising selling price is an exercise based on forecast demand and marginal costs over a coming period such as a year. It does not involve asking whether a product should be sold at all, whether its design should be modified or how its selling price should be influenced by the position of the product in its life cycle or the product matrix of the business.
An understanding of corporate planning is essential for all management because lower-level objectives are inexorably linked to higher-level strategies. An appreciation of these strategies and how they are formulated can be an effective guide to action and improving performance.

Moreover, whatever the level at which a manager operates within an organisation, he or she can have some influence over that organisation’s strategic (corporate) strategy.

Critical success factors (CSFs) are as follows:

**Product quality** – the fact that production staff may have no previous experience in a food production environment is likely to prove problematic. It is vital that a comprehensive training programme is put in place at the earliest opportunity. DY need to reach and maintain the highest level of quality as soon as possible.

**Supply quality** – the quality and timeliness of delivery into Jacksons supermarkets assumes critical significance. Hence supply chain management must be extremely robust as there is little scope for error.

**Technical quality** – compliance with existing regulators regarding food production including all relevant factory health and safety requirements is vital in order to establish and maintain the reputation of DY as a supplier of quality products. The ability to store products at the correct temperature is critical because yogurts are produced for human consumption and in extreme circumstances could cause fatalities.

**External credibility** – accreditation by relevant trade associations/regulators will be essential if nationwide acceptance of DY as a major producer of frozen yogurts is to be established.

**New product development** – while DY have produced a range of frozen yogurts it must be recognised that consumer tastes change and that in the face of competition there will always be a need for a continuous focus on new product development.

**Margin** – while DY need to recognise all other CSFs they should always be mindful that the need to obtain desired levels of gross and net margin remain of the utmost importance.

**Note**: only five CSFs were required. Alternative relevant discussion and examples would be appropriate.
Building and Monitoring critical success factors

Critical success factors (CSFs) are those areas of business performance where the company must succeed in order to achieve its overall strategic objectives. Monitoring CSFs are those that are used to keep abreast of ongoing operations, for example, comparison of actual results to budgets or industry averages. Building CSFs are those which look to the future of the organisation and its development, for example, the launch of niche products such as music concert films or the use of new distribution methods such as downloadable films.

Information for establishing CSFs

The company can use information about the internal and external environment to set its CSFs. Relevant external information would include the structure of the industry and the strategy of FP’s competitors. The geographical location of production and the main sales markets may also be relevant. Film is a hit driven industry where word of mouth can lead to success, therefore, recognition of the product and the brand (‘Film Productions’) by the public would lead to success. For example, the Walt Disney Company has achieved a high level of brand recognition that has enabled it to expand into other entertainment areas using characters from its films.

Relevant internal information would include measures of seasonality on sales which will dictate the timing of film releases and effectiveness of marketing campaigns. By forecasting the size of the market along with likely levels of competition, profit can be optimised. However, these forecasts will be subject to uncertainty and so the information systems will need to be flexible and allow probabilistic analysis. A CSF based on the quality of these forecasts would therefore be appropriate. Other internal sources could include measures of the cost per film and the time taken to produce a film.

Other possible information could include contingent factors (those that depend on specific threats or opportunities facing FP).
(c) Performance indicators linked to the CSFs

**Audience satisfaction – performance indicators are:**

- Sales per film – currently the company releases an average of 6.4 films per year and makes about $31.25 million on each one. These figures should be compared to industry averages. Trends on sales per film should be monitored for indications of changes in consumer taste.

- Brand recognition – consumers should be surveyed to identify if the FP name is known and used as an indicator of quality when selecting films. If FP regularly uses certain artists (directors or film stars) then positive consumer recognition of these names will indicate satisfaction.

- Repeat viewings – with TV showings, it will be possible to measure viewers for each showing of the film and monitor the decline in viewing over repetitions. The level of DVD purchases following a cinema release will also indicate customer satisfaction with customers actively wanting to own their own copy of a favourite film.

- Awards won – number of awards won will indicate success. However, the level of recognition of any award must be brought into account as major ones such as those voted on by the public or those whose ceremonies are widely reported have the greatest impact.

- Response of the media – scores by film critics often appear in the media and these give a measure of satisfaction although this category must be treated carefully as critics often look for artistic merit while FP is seeking commercial success and broad audience acceptance.

**Profitability in operations – performance indicators are:**

- Industry average margin – collect data on competitor companies to set an appropriate benchmark. This will require care to ensure that appropriate comparator companies are chosen, for example, those with a production budget similar to FP’s of $18 million per film.

- Time in production – the cost of a film will depend on the length of time it takes to produce. If the film is intended to meet a current customer demand it may require to be produced quickly, in order to meet revenue targets. Therefore, the time in production will affect both sales and cost levels so altering the gross margin. Again, it would be helpful to identify if films meet their production schedule and if these schedules compare favourably to those of other film companies.
Costs – the costs should be broken down into categories such as those for artists, production technicians and marketing. The cost structure for each film should be compared internally, to others that FP produces and also externally, to available figures for the industry.

(d) **Impact on FP’s information systems**

The company website can collect audience survey results and comments posted on the site. Consumers can be drawn to the site with clips and trailers from current films and those in production. The site can log the frequency with which films are viewed and if audience members create accounts then further detail on the age, gender and location of the audience can be collected. This will allow a more detailed profile of the customer base for FP to be created and will be used to help in decisions about what films to commission in the future. The account members can be given the opportunity to score each film providing further information about satisfaction.

The company could also consider scanning the websites of its competitors to identify their performance – especially their published results which will provide benchmark information on gross margin levels.

A management information system (MIS) will collate the information from individual transactions recorded in the accounting system to allow middle level management to control the business. This system will allow customer purchases to be summarised into reports to identify both products that sell well and the customers (such as cinema chains and TV networks) who provide the main sources of revenue (indicators of satisfaction). The level of repeat business on a customer account will give an indication of the satisfaction with FP’s output. The system will also produce management accounts from which gross margins will be drawn and it should be capable of breaking this down by film and by customer to aid decision-making by targeting FP’s output to the most profitable areas. This will aid decision-making about the performance of the production team on a film and can be used to set rewards for each team.

An executive information system (EIS) is one that will supply information to the senior management of the organisation allowing them to drill down into the more detailed transaction reports where necessary. The EIS will provide summarised information, focused on the key performance indicators in order to allow the directors to quickly judge whether the company is meeting its CSFs. It will draw on internal sources such as the MIS and also external sources such as market data on revenues that different films are earning at the box office.
Possible steps include:

- involving local managers in strategy formulation
- agreeing strategies with business units within certain boundaries
- ensuring performance management reflects a combination of short- and long-term issues
- permitting flexibility within the strategic planning process to allow for changes due to local circumstances
- a combination of strategic planning and freewheeling opportunism (no strategic plans). For example, strategic planning may be used for activities such as identifying the organisation's resource capability and its resources. Freewheeling opportunism may be used to exploit an organisation's competences, e.g. the skills of particular individuals or groups.

Strategic management accounting may assist the decision making process as follows:

- analysis of the market for different types of product:
  - review of competitors' products
  - likely size and value of different market sectors
  - price comparison of different products
- forecasts of costs of manufacturing new products, comparing different levels of automation/use of temporary staff
- forecasts of profitability of different products
- investigation of capital costs of different options and investment appraisal of possible options
- analysis of the cost of holding inventory under different options.
Possible factors could include:

**Process**

In order to manage and improve performance, the company needs to determine where best to locate activities related to the new market, e.g. whether to manufacture products in South America as well as selling there. This will require a comparison of the total product costs with manufacture in different locations, including measurement of factors such as:

- labour costs
- materials – costs of purchasing in different areas, costs of sourcing elsewhere and transporting to manufacturing site
- distribution – costs under different scenarios including setting up own sales force, using existing distributors
- costs of after-sales support.

**Product**

In addition to changes in manufacturing costs due to the location of manufacture there may be additional costs if products need to be tailored for the South American market. These need to be estimated in order to manage performance and ensure that the goals are met.

**Exchange rates**

The company needs to assess the impact of exchange rate fluctuations on the value of income earned in South America. There is a need to consider how this risk will be managed, e.g. by hedging. An ongoing assessment should be made of exchange rates and risk management techniques.

**Political risk**

The company needs to be aware of the possibility of an unexpected politically motivated event in S. America affecting the outcome of the investment and hence the performance of the company, e.g. the government may decide to raise taxation. Again, an ongoing assessment should be made of any risk.
Administrative issues

The financial impact of a number of other factors needs to be incorporated into the evaluation of the options such as the impact on internal transactions of exchange rate movements, currency exchange controls and tax regimes. There will, e.g. be implications for any transfer pricing system. Exchange rate fluctuations also need to be taken into account in developing performance measures for business unit managers in overseas locations to ensure that they are not being penalised for changes in income which are out of their control.

Test your understanding 9

(a) The benchmarking process can be described using seven steps. These are outlined below, together with AV’s current progress against these stages.

(1) **Set objectives and decide areas to benchmark**

   It is not clear exactly what AV’s objectives are here, as “improve performance” is too generic. AV must carefully identify what specific areas it is looking to improve upon – for example, reduced repair costs, improved staff productivity, better rental collections.

(2) **Identify key performance drivers and indicators**

   To some extent these can be identified by looking at the expense headings in the Income statement. AV will improve performance by operating more efficiently across its major cost headings. It should be noted here that as a not for profit organisation performance will be measured in a different way from BW. For example, AV will not wish to increase rentals charged in order to report a surplus, so measures of efficiency become much more important so that it can provide good quality accommodation within the cost constraints imposed by the rents received.
AV has selected a profit motivated company, BW, for benchmarking against, so this step has been carried out. However, it is not clear how this partner has been selected. Whilst there may be some examples of best practice to be learned from, it should again be noted that BW is profit motivated and so will have fundamentally different objectives from AV.

Some basic data has been gathered here. This is the stage that AV has now reached, as there is as yet no comparison of, or commentary on, the relative performance of the two organisations. Part (b) addresses this area.

Once the comparisons above are made this should identify areas for improvement. Care should be taken that processes identified at BW can be transferred across to AV. Again, given their widely different objectives, this may not be possible. AV may also need to retrain some staff (or even recruit others) to ensure the requisite skills are in place.

Management must continuously monitor the impact of any changes implemented to make sure that the intended benefits are realised. Without this monitoring, any changes may be short lived because staff may soon revert back to their familiar way of doing things.

So, in conclusion, AV has identified a benchmarking partner (albeit one that may not be wholly suitable), and has collected some basic operational and financial data for comparison. It needs to more clearly define its objectives before it can proceed to specify actions for improvement.
(b) As discussed in part (c) below, it is not surprising that we see some major differences between the two organisations as they have very different objectives.

(1) **Rental income**

AV has average rental income per property of $52 per week compared to $120 per week for BW. This is not surprising, given that AV wants to make cheap housing available to as many people as possible, and BW seeks to charge higher rates for premium properties to tenants who can afford to pay. This should not be seen as an indicator that AV should increase its rents.

It should also be noted that the mix of properties is different. AV has a larger proportion of 3 and 4 bedroomed properties (presumably to cope with large families), whereas BW has no four bedroomed property. Taking this into account, the rentals on a “per room” basis are even higher for BW.

(2) **Staff salaries**

The average annual salary per employee in AV is $18000, whereas it is $24800 for BW. Again, this can largely be explained by the differing objectives that will encourage AV to keep costs to a minimum. It should be noted, however, that there may be a trade – off here between cost and productivity. If AV paid higher salaries would it be able to recruit better quality staff who are more productive? Staff numbers (25 in total) are the same for both companies, even though AV has 900 properties compared to only 400 for BW. This may lead to a reduced level of service for AV, which in turn could lead to a delay in dealing with problems such as repairs or collecting overdue rent.
(3) **Planned maintenance and repairs**

The major repair and maintenance cost for AV totalled $682,400, which is over three times as much as BW. There are two likely reasons for this. Firstly AV has more than twice as many properties (900 compared to 400), and secondly it may well be that their housing stock is in poorer condition and therefore needs more maintenance. It should also be noted that the repair costs are higher per property for BW (replacement kitchens cost twice as much as for BW for example), which will again reflect their different objectives and the needs of their clients. This should not be interpreted to mean that AV is “more efficient” as it is almost certainly not a like for like comparison. Hence, as noted in part (c) below, benchmarking against other not-for-profits may yield more meaningful comparisons.

One point that should be noted – there is always a possible trade off between cost and quality. If AV paid more per repair, would the quality be better and therefore the repairs last longer before further expenditure is needed?

(4) **Day-to-day repairs**

AV has undertaken a total of 3,860 repairs in the year at an average cost of $124 per repair. BW has carried out 1,276 repairs at a cost of $100 per repair. Whilst there is not a massive difference per repair, a saving of $24 per repair would result in overall cost savings of $92,640.

AV should carry out further research as to how BW has obtained a fixed fee per repair, and see if it can obtain a similar contract as this could produce significant savings.

(5) **Sundry operating costs**

Whilst these are 30% higher for AV ($305,500 compared to $235,000), we have no breakdown of the figures and so cannot really comment further. It seems reasonable that, since AV has more than twice as many properties and tenants, it will incur a higher level of costs here.

(6) **Net interest and other charges**

Again no analysis is given, so no further comment is possible.
Conclusion

AV clearly operates at the “lower end” of the rental market compared with BW. It has more properties and charges lower rents per property. It is likely that the housing stock is in poorer condition, and so necessitates more ongoing repairs and maintenance. Attention should be given to getting the best possible deals from suppliers on repair work, perhaps negotiating a “fixed fee” in the same way as BW has done. It is surprising that staffing levels are the same for both companies as AW has more than twice as many properties.

Overall though, it should be noted that the two organisations have totally different objectives that may well go some way towards explaining these differences.

(c) AV has chosen to benchmark itself against BW, a profit seeking company operating in the same sector. There are a number of advantages to this chosen method of benchmarking. Firstly, it is method of learning from the success of BW and for learning and applying best practices. Secondly, it will help AV in assessing its current positioning and identifying any gaps in performance.

However, there are a number of drawbacks. Firstly, this benchmarking exercise will be costly in terms of time and money. Before investing any more funds in the exercise, it is important that AV’s directors determine if the cost of the exercise is less than the benefit. Secondly, BW may not be the best practice organisation. How was this benchmarking partner chosen? Another drawback is that too much attention may be paid to the aspects of performance that are measured as a result of the benchmarking exercise, to the detriment of the organisation’s overall performance.

Finally and most importantly, as mentioned previously, the two organisations differ fundamentally because of their objectives. The objectives of not-for-profit organisations like AV can vary significantly. AV’s primary objective is to “meet the accommodation needs of persons in its locality”. So, it is likely to want to keep as many people as possible in accommodation regardless of cost. How can it measure whether or not it has met this non quantiative objective? Could it in fact have provided more properties if it had adopted different policies relating to staff or repairs?
BW has a primary objective of maximising profit. This is a clear and measureable objective that will probably lead BW to provide high quality accommodation in desirable areas that will generate high revenues and profits. This will support high rents (the average property rental for BW is $120 per week compared to $52 per week for AV) and will necessitate quality repairs and maintenance and customer service levels. Whilst efficiency will still be important for BW, to some extent it can pass on higher costs to its tenants by increasing rents.

AV on the other hand will seek to maintain low rents, and to provide as much housing as possible within its budgetary constraints. This will necessitate a very high level of efficiency as it will not seek to pass on high costs to its tenants. So, like any not-for-profit the critical measures of economy, efficiency and effectiveness must be considered.

Because of these fundamental differences AV would be better advised to consider benchmarking against other similar charities. This would give it much more meaningful comparisons as the objectives of the organisations would be more closely aligned. In addition, charitable organisations are generally more willing to share information to their mutual benefit, so such benchmarking partners may be readily found.

The use of a benchmarking partner that shares similar objectives would allow AV to obtain a much more objective comparison for its own performance.
### Test your understanding 10

<table>
<thead>
<tr>
<th>Strengths:</th>
<th>Weaknesses:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Airports used are better than those used by competitors</td>
<td>• Airports used are worse than those used by the big carriers</td>
</tr>
<tr>
<td>• Management skills</td>
<td>• Punctuality</td>
</tr>
<tr>
<td>• Lower costs than established airlines</td>
<td>• Cash flows</td>
</tr>
<tr>
<td>• Ease of booking flights</td>
<td>• No established safety record</td>
</tr>
<tr>
<td>• Recognised logo</td>
<td>• Poorer than average customer service.</td>
</tr>
<tr>
<td>• IT facilities</td>
<td></td>
</tr>
<tr>
<td>• Good employee relations.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Opportunities:</th>
<th>Threats:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Strong business demand for cheap air fares</td>
<td>• Higher airport charges</td>
</tr>
<tr>
<td>• Strong leisure demand for cheap air fares</td>
<td>• Stringent security checks</td>
</tr>
<tr>
<td>• Full exploitation of the Internet</td>
<td>• Entry of subsidiaries of big carriers.</td>
</tr>
<tr>
<td>• Many secondary airports underused.</td>
<td></td>
</tr>
</tbody>
</table>
(a) **Strengths:**

- Successful company
- Steady increase in market share
- Experience in the market
- Founder’s entrepreneurial skills
- Good designs
- Good quality control
- Keen to exploit to technology
- Strong IT

**Weakness:**

- Management of information is often out of date
- No in-house IT expertise
- No web experience
- Not sure if the new system will generate new sales
- Lack of control over store managers
- Out of date reporting from some stores
- Over reliance on IT provider

**Opportunities:**

- E-trading can provide a new sales channel and revenue stream
- Identification and recording of customer details to enhance customer relationships
- Extension of customer base
- Global market potential
- Cut costs in many areas
- Create a vision of a modern company
- Develop product range further
- Look at employing an IT specialist
Threats:

- Customer resistance to on-line shopping
- Loss of unique identity; may become just another website trader
- Resistance within the company
- Effects on existing personnel and working conditions
- Costs of developing the website may outweigh the benefits
- Security issues
- Loss of competitive edge

Note: marks would be awarded for other relevant points.

(b) It is important to consider how these factors link to performance measurement in Envie Co:

- **Identifying weaknesses:** SWOT analysis has identified that Envie’s lack of web experience is a weakness and therefore Envie needs to try to address this weakness and turn it into a strength by developing a website to reach global markets. It will be important for Envie Co to measure revenue and revenue growth for its website in order to assess how well it is performing. The use of SWOT analysis will focus management attention on current strengths and weaknesses of the organisation which will be of assistance in formulating the business strategy. It will also enable management to monitor trends and developments in the changing business environment. Each trend or development may be classified as an opportunity or a threat that will provide a stimulus for an appropriate management response. Management can make an assessment of the feasibility of required actions in order that the company may capitalise upon opportunities whilst considering how best to negate or minimise the effect of any threats.

- **Identifying CSFs:** SWOT analysis has identified unique designs and good quality control as key to the expansion of Envie Co. This therefore suggests that it will be important to have performance measures which look at the effectiveness of the design team and the quality of the products produced.

- **Setting targets:** one of the opportunities identified is ‘the extension of the customer base’. This could be linked to financial objectives, such as revenue growth targets for new customers. Envie’s managers will need to monitor the targets set to assess how well performance compares to them.

- **Information needs:** Envie Co will need to collect information in relation to measuring and reporting on the KPIs set.
<table>
<thead>
<tr>
<th>Division</th>
<th>Market growth (% change in annual market revenue)*</th>
<th>Division’s market share (most recent divisional revenue/market revenue)</th>
<th>Relative market share (division’s market share/market leader’s share)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premier</td>
<td>14.6%</td>
<td>10%</td>
<td>0.58</td>
</tr>
<tr>
<td>Organic</td>
<td>1.9%</td>
<td>78%</td>
<td>1.00</td>
</tr>
<tr>
<td>Baby</td>
<td>10.2%</td>
<td>3%</td>
<td>0.12</td>
</tr>
<tr>
<td>Convenience</td>
<td>2.8%</td>
<td>3%</td>
<td>0.10</td>
</tr>
</tbody>
</table>

* This is the average growth over the four year period.

The management could use the BCG matrix in order to classify its subsidiaries in terms of their rate of market growth and relative market share.

The model has four categories. These are:

**Stars**

A star product has a relatively high market share in a growth market.

The Premier division is experiencing strong growth in a growing market.

It has a 10% market share and therefore it seems reasonable to categorise the Premier division as a star.

**Problem child**

They have a relatively low market share in a high growth market. The Baby division would appear to fall into this category. The market leader enjoys a 25% share whilst the Baby division appear to be struggling to achieve growth in turnover and hence profits.

**Cash cow**

A cash cow is characterised by a relatively high market share in a low growth market and should generate significant cash flows.

The Organic division appears to be a cash cow since it has a very high market share in what can be regarded as a low growth market.
**Dog**

A dog is characterised by a relatively low market share in a low growth market and might well be loss making. The **Convenience** division would appear to fall into this category since its market share is very low and it has low growth.

Food for thought has a dog and a problem child that both require immediate attention.

Competitors within the sector will resist any attempts to reduce their share of a low growth or declining market. As far as the problem child is concerned, the management need to devise appropriate strategies to convert them into stars.

**Remuneration package**

The existing remuneration policy links the divisional manager’s bonus to the achievement of the cost budget set at board level. This may be seen as appropriate for the Organic and the Convenience divisions since they are both in low growth markets and therefore adherence to cost budgets should be possible. However, the Premier and Baby divisions are in high growth markets. Therefore, linking the manager’s bonus to the achievement of the cost budget may discourage the manager from making the investment that is required to take advantage of the growth opportunity.

There also seems to be an inconsistency between the way the remuneration package is determined and the method used to evaluate divisional performance. Divisional performance is measured using EVA and this is broadly consistent with the company’s objective of maximisation of shareholder wealth. However, by failing to link the remuneration policy to EVA and the company’s objective, dysfunctional behaviour may occur.