UNIT 3: BUSINESS ANALYSIS AND STRATEGY

Analysing Non-Financial Performance

Non-Financial Measures of Performance

Managers want to measure business performance. This is frequently carried out by analysing and evaluating the financial aspects of the business.

However, it is also extremely important to measure the non-financial aspects to ensure that the business is working as efficiently as possible and that it is meeting all its objectives, some of which will probably not be connected to the business' finances.

Examples of non-financial performance indicators are:

1. productivity
2. market share
3. sales targets
4. environmental impact
5. quality
6. customer satisfaction.

Productivity

Definition: This is the output produced in relation to the inputs used. For a given time period this could be; output per worker; output per machine; output per site.

Productivity is a crucial concept as it can have a significant effect on the costs of producing a unit. Consequently, managers are constantly seeking ways to improve productivity (particularly labour productivity) as it means the business will either make more profit per unit or it can reduce the price to become more competitive.

Methods of improving labour productivity are:

- increasing the number of hours worked
- training
- investment in equipment and technology
- changing the way work is done
- motivating employees.

Quality

Targets can be set for the number of defects produced by a production process within a given time frame, or the number of faulty goods returned by customers. Businesses are always looking at ways of improving quality as poor quality indicates a lack of efficiency and it increases costs and, consequently, reduces profit. In addition, producing poor quality products can affect a business' reputation.

There are national and international quality standards that businesses can strive to meet, such as 'Investors in People' and ISO 9000. The gaining of such awards, and keeping them, can partly measure a business success.

Window Dressing

Definition: 'Window Dressing' is the term used to describe techniques for **improving a business' balance sheet position**, in particular its apparent liquidity.

Although accounts must represent a 'true and fair record' of the financial affairs of a business, businesses may manipulate their accounts legally to present different financial pictures.

Why would a business want to make itself look as successful as possible?

- To **please the shareholders** of public limited companies – a high profit usually means a high share price.
- To **show growth in terms of sales**, value of fixed assets or dividends; for example, to impress potential investors.
- In order **to raise finance** from a bank or any other source.
- To **increase the likelihood of a merger** with, or takeover by, another firm.

Why would a business NOT want to make itself look as successful as it has been?

- To **reduce the risk of a hostile takeover**.
- To **delay paying tax** until the next financial year.

Market Share

This measures the sales of a business relative to the market size. It is calculated using:

$$\frac{\text{Sales of a business}}{\text{Total sales in a market}} \times 100\%$$

The sales can be measured either in financial terms or volume (the number of items).

Market share is important as it might indicate that a business is the market leader. This might influence the strategy or objectives of the business. A business with a small market share may set a target of increasing its share by a certain amount over a fixed period. Market share might be an indication of the success or the failure of a business or its strategy.

Environmental Impact

Consumers are becoming increasingly concerned about the effect that business activity has on the environment. As a result many organisations have environmental policies, which seek to limit the amount of pollution damage they do (air and noise pollution and waste disposal), restricting the damage done to wildlife, developing brownfield sites (as opposed to greenfield sites), using renewable energy sources and promoting conservation measures, for example.

Businesses regularly set themselves environmental targets that they wish to achieve, such as reducing waste by 20% over the next year. In addition, many businesses are carrying out environmental audits whereby they assess the environmental impact their activities are having.

	BENEFIT OF THE MEASURE IN ASSESSING PERFORMANCE	DRAWBACK OF THE MEASURE IN ASSESSING PERFORMANCE
Productivity	High productivity can lead to lower unit costs.	Speed of working may reduce quality.
Market Share	An increase can indicate the success of the business.	It does not show if the market is growing or shrinking.
Sales Targets	Indicates whether objectives have been met.	Factors outside the business' control might have caused sales targets to be missed, or their overachievement.
Environmental Impact	This is a 'hot topic' amongst consumers at present; anything that can be done to make a business appear to be more environmentally friendly is likely to impress current and potential customers.	It can take quite a long time for environmental policies to take effect, as it may require new suppliers to be sought or there may be a very gradual reduction in pollution, for example.
Quality	Consumers wish to purchase good quality products; a rise in quality is likely to lead to an increase in demand and, consequently, an increase in profit.	Some measures used to increase quality may not be cost-effective as the cost of them outweighs the potential gain.
Customer Satisfaction	Contented customers are vital to a business' success, particularly if they remain loyal to the business.	It can be difficult to measure customer satisfaction, particularly when using questionnaires as only those not happy with a business' products may respond.

How can a Business Window Dress its Accounts?

Manipulating sales: Choosing whether to record a sale when an order is placed or when the money has been received. (This might span two financial years.)

Depreciation: Assets can be written off over different time spans – for example, if a piece of machinery is written off over 3 years, the profit will be less each year for those three years than if it is written off over 10 years.

Appreciation: Businesses do not tend to get a professional valuation of its property each year, which means that the estimate given could be over or under the true value. The value of stock, similarly, may be over- or under-estimated.

Writing off bad debts: A business may choose in which year to accept that a debt will never be paid and to reduce its profit accordingly.

Borrowing money for a short period to improve its cash position: This enhances a business' apparent ability to pay its short-term debts.

Sale and leaseback: This involves selling assets (which improves the cash position) and then leasing back the same assets.

Presenting the company account in a favourable light - to flatter the business performance.

Sales Targets

This measures the amount of sales that a business makes (either in terms of money or volume) in a specific time period compared with what it set as an objective (or budget).

Targets are set as goals to aim for. They are often included in a business' budget because the amount of revenue generated from sales will indicate how high the expenditure budget can be. Targets can motivate staff. However, if they are set too high or too low, they can have the opposite effect.

Customer Satisfaction

This stems from customer service, which is about meeting the needs of customers. Customer service/satisfaction has become increasingly important in recent years due to market orientation and the importance of customers to businesses. If businesses offer good customer service/satisfaction, they are more likely to see customers return and for customers to recommend them to others.

Customer satisfaction can be measured, amongst other methods, through questionnaires, recording telephone conversations, repeat purchases, referrals from existing customers and the number of complaints. Targets can be set to assess the performance of the business in this respect.

Which Measure is Best?

The most appropriate measure of performance will depend on the nature of the business:

- An airline might measure the proportion of flights that take off and land on time.
- A call centre might measure how many calls are taken in a day and how long it takes to answer them.
- A college might measure its absolute exam results or the value it has added to students' performance.