

PERFORMANCE MANAGEMENT

“Old” performance management and “new” performance management – pros and cons

Assignment report
Performance Management

Promoter
Prof. Bino Catasus

Authors
Tomasz Ćwik tomasz.cwik@wsip.com.pl
Andrzej Tracz andrzetracz@hotmail.com

Cracow, April 2006

CONTENT

| | |
|---|-----------|
| Abstract..... | 2 |
| 1 What is new in economy?..... | 3 |
| 1.1 Background..... | 3 |
| 1.2 What are intangibles? - Intellectual capital model by Scandia..... | 3 |
| 1.3 Are intangibles so important?..... | 4 |
| 1.4 Intangibles assets in Poland. Market to book value ratio..... | 4 |
| 1.5 "Old" and "New" performance management models – definitions..... | 5 |
| 2 Traditional measurement tools..... | 5 |
| 2.1 Traditional measurement tools – short overview..... | 5 |
| Financial accounting..... | 5 |
| Management accounting..... | 6 |
| Budgeting..... | 6 |
| 2.2 Main features - discussions..... | 6 |
| Intangible expenses – cost or asset?..... | 6 |
| Time referring, focusing on financial results..... | 6 |
| Traditionalism – availability of frameworks of measurement systems..... | 7 |
| Standardization..... | 7 |
| Is it enough to have a traditional system?..... | 7 |
| 3 New performance management tools - management models..... | 8 |
| 3.1 New performance management tools- short overview..... | 8 |
| Measurement of intellectual capital - Skandia Navigator..... | 8 |
| The Balanced Scorecard – Harvard School model..... | 9 |
| The MERITUM model – a European approach..... | 9 |
| Economic Value Added (EVA™)..... | 10 |
| 3.2 Main features - discussion..... | 11 |
| An attempt to measure intangibles..... | 11 |
| Multidimensional approach..... | 12 |
| Time consuming..... | 12 |
| Too many measures..... | 12 |
| No external comparison..... | 12 |
| Participation and commitment of staff..... | 12 |
| 4 Summary..... | 13 |
| 5 References..... | 13 |

Abstract

"What you measure is what you manage" says one of the most famous performance truisms. Taking it into consideration organizations implement more and more sophisticated methods of measuring and managing of their performance. Among years that systems has evaluated becoming much more detailed providing standardised set of information to their recipients

Nowadays we live in "new economy", economy that basis its value on knowledge, information, brands, know-how, licence and other intangible assets that despite that do not have its physical form sometimes presents a significant or even fundamental part of company value. Some companies also polish one, build its value mostly on intangibles rather than on typical physical resources.

This new economic order challenges and offers innovative opportunities to the audit professionals and financial analysts and to the top managers. It became obvious that traditional methodology that was created to measure tangible assets may not be such efficient or even may appear irrelevant to measure intangible. In particular, the so-called intellectual capital supplements starts to be more popular part of annual reports of companies those assets are mostly intangible. This data pose a real problem of verification and scope of information which are disclosed to institutional investors and the general public. The procedures for verification and assessment of this new information are immature and need to be standardized and agreed at an international level.

Report is divided into four chapters. Chapter number one describes new trends in economy that is much more depending on intangible assets. Second chapter shortly describes main traditional measurement system as well as reveal its advantages and disadvantages. The same construction

regards to chapter no. 3 where pros and cons of new performance systems are discussed. At the end of the report reader will find short summary of the findings.

1 What is new in economy?

1.1 Background

It is now commonly accepted that we are in the midst of a new phase of evolution in the major global economies, which is characterized by new performance and value drivers that are mainly intangible. So-called intangible or knowledge economy is the new environment that companies have to learn to cope with. During the last two decades most industrialised economies have progressively moved towards a knowledge-based rapidly changing economy where investments in human resources, information technology, R&D and advertising have become essential in order to strengthen a firm's competitive position and ensure its future viability.

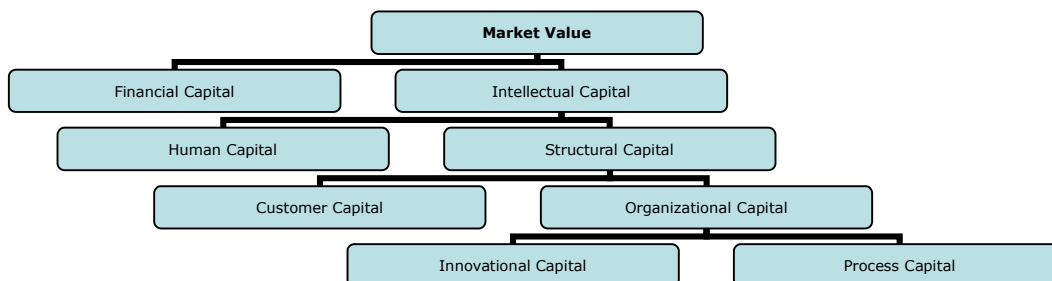
With the transition to a knowledge-based economy, the principal source of economic value and wealth is no longer the production of material (tangible) goods but the creation and management of intangible assets. In other words, economic growth is not as much influenced by investments in physical capital (i.e. land, machinery etc.), as by intangible assets which is a critical determinant for the productive and exploitation of physical capital. Consequently, some companies depend on being able to measure, manage and develop their intangibles.

This new phase is having profound implications also for corporate accounting and reporting. It is well known that there is a gap between the accounting book value and the market value of many internationally-listed companies as well as polish. There is also widespread concern about the difficulty of valuing and assessing the performance of 'new economy' companies. Some companies have recognized this new phase and started to produce reports which are largely different from the traditional, financially-oriented ones. (Some examples will be presented in next chapter 3). These reports may take different names (intellectual capital report, auxiliary balance sheet, report on intangibles etc), but they have a common goal of penetrating beyond the financial dimension in order to identify and track the new value drivers - mainly of an intangible nature - which permit long-term, sustainable growth of the company.

1.2 What are intangibles? - Intellectual capital model by Scandia

One of the first significant attempts of classifying and reporting the value of intellectual capital took place in 1994 by the group of specialists of Swedish financial service firm Scandia. At that time Professor Leif Edvinson was appointed as a world first Intellectual Capital Director at Skandia AFS. In 1994, Skandia began to publish a series of intellectual capital supplements to its financial accounting statement.

Graph 1 Intellectual Capital according to Skandia



Source: Customer Value. Intellectual capital. Supplement to Skandia's 1996 Annual Report, page 4

According to Skandia's model market value of the company maybe divided into financial capital and intellectual capital. Financial capital is simply the company book value and contains all assets presented in traditional balance sheet. The rest of company value consists of intellectual capital that is subdivided into human capital and Structure Capital. What is important - human capital is not owned but rented and left company after 5 pm. On the contrary structure capital is the part that is still in the firm after 5 o'clock. This comprises corporate culture, management processes, IT

systems, databases, reputation, brands and intellectual property. Naturally, that part of IC is controllable by the management and it is obvious that one of the main objectives of IC management is to move the value form human part to the structure. Skandia divided Intellectual capital more deeply into next layers. Entire intellectual capital classification according to Skandia is presented on the graph Graph 1.

It is necessary to say that Skandia definition is not only one approach to the intangible assets described in literature. Many of them like MERITUM¹ project have different approaches to that problem but have common elements. They tend to classify intangible as knowledge assets (such as those resulting from investments in R&D and often codified in patents), human capital, and organisational capital.

1.3 Are intangibles so important?

Defining intangible assets arise the question about its value and scope of New Economy. It is estimated that that the market-to-book ratio of the S&P 500 companies is in excess of 6.0, compared to just over 1.0 in the early 1980s. While some of this difference is attributable to the current values of physical and financial assets exceeding their historical cost, a large proportion is due to the rise in the importance of intangible assets. Intangibles (sometimes referred to as knowledge assets or intellectual capital) have, therefore, become the major value driver for many companies. These assets are generated through innovation, organizational practices, human resources or a combination of these sources and may be embedded in physical assets and employees.

1.4 Intangibles assets in Poland. Market to book value ratio

Because of the increasing relevance of intangibles this part of the report will presents how much is Intellectual Capital (measured as a difference between book and market value) of the polish blue chips (20 stocks that are component of polish blue chips index WIG 20).

Table 1 Compression market to book value of 20 polish blue chips (Wig20 index)²

| Company | Sector | Market Value mln Euro | Book Value mln Euro | Intellectual Capital | Ratio |
|----------------|-------------------|---------------------------------|-------------------------------|-----------------------------|--------------|
| TVN | Media (TV) | 1 407 | 99 | 1 308 | 14,21 |
| Bioton | Biotechnology | 733 | 61 | 673 | 12,12 |
| PKOBP | Banking | 8 475 | 2 208 | 6 267 | 3,84 |
| PKO | Banking | 7 625 | 2 106 | 5 520 | 3,62 |
| BankBPH | Banking | 5 664 | 1 590 | 4 074 | 3,56 |
| Softbank | IT | 236 | 72 | 164 | 3,28 |
| BZWBK | Banking | 2 745 | 859 | 1 886 | 3,20 |
| GTC | Real estate | 1 365 | 445 | 920 | 3,07 |
| Agora | Media | 745 | 277 | 468 | 2,69 |
| BRE | Banking | 1 303 | 527 | 776 | 2,47 |
| KGHM | Metal | 3 495 | 1 591 | 1 904 | 2,20 |
| MOL | Petroleum | 8 651 | 4 007 | 4 644 | 2,16 |
| Kęty | Metal | 269 | 150 | 119 | 1,80 |
| Prokom | IT | 504 | 290 | 214 | 1,74 |
| TP | Telecommunication | 7 490 | 4 498 | 2 993 | 1,67 |
| Orbis | Tourist | 514 | 407 | 107 | 1,26 |
| PKNOrlen | Petroleum | 5 934 | 4 867 | 1 068 | 1,22 |
| Lotos | Petroleum | 1 393 | 1 207 | 186 | 1,15 |
| PGNIG | Energy | 5 059 | 5 197 | -137 | 0,97 |
| Netia | Telecommunication | 514 | 588 | -75 | 0,87 |
| Total | | 64 120 | 31 042 | 33 078 | 2,07 |

Source: Warsaw Stock Exchange

According to table above investors valuated polish blue chips (only) 2,07 times above their book value. According to concept that the intellectual capital may be calculated as a difference between

¹ The European Union project on Measuring Intangibles to Understand and Improve Innovation Management (MERITUM) was funded within the framework of the Targeted Socio-Economic Research (TSER) programme between 1998 and 2001.

² Market value on 10 March 2006, Book Value according to 4thQ financial report. Warsaw Stock Exchange

book and the market value it state at 33 billion Euro. The book to market ratio is even lower when we took into account all companies listed on Warsaw Stock Exchange – 1,89.

It reveals that also in Poland, where no many companies run its business in knowledge economy, investors are willing to valuated companies above its book value. Amazing value presents two companies TV and Bioton, that although, operates in new-economy but its book value is only about 7% of the market value (the rest is IC). Is it valuation really reliable or is it another dot.com bubble?

Presented data confirms that also some of the polish companies should revise possibilities of implementing (if have not implemented yet) some of the knew intangibles measurement and management tools. Some of the "new approaches" will be presented in the next chapter.

1.5 "Old" and "New" performance management models – definitions

The basic process of performance measurement consists of four main phases³. The first phase is to decide what to measure and then to choose or design suitable measures. Measurement can be carried out using individual performance measures or a performance measurement system which consists of several individual measures. In the second phase, (the measures or) the measurement system is implemented in the organisation. This includes e.g. determining how the data is collected, how the measurement results are reported and how the measures are used. After the measurement system has been designed and implemented, the third phase is simply to use the measures. The final phase, the updating of the measurement system, closes the loop.

Performance measures models may be divided according many criteria. Some of them were used to divide them into "old" and "new" performance measurement systems⁴.

Table 2 Criteria of dividing „Old" and „New" performance management tools.

| Criteria | "Old" | "New" |
|---------------------------------------|---------------------|---------------------------|
| Direct vs. indirect measures | Direct | Indirect |
| Leading vs. lagging measures | Lagging | Leading |
| Monetary vs. non-monetary measures | Monetary | Monetary and not-monetary |
| Qualitative vs. quantitative measures | Rather quantitative | Rather Qualitative |
| Result vs. cause measures | Rather result | Rather cause |
| Subjective vs. objective measures | Objective | Rather Subjective |

2 Traditional measurement tools

2.1 Traditional measurement tools – short overview

Financial accounting

Financial accounting and reporting practices have traditionally provided a basis for evaluating a company's business performance. The fundamental objective of financial accounting is to provide users of financial statements or other report useful information for the purpose of efficient and effective decision making.

Outside of the firm, financial reporting should provide information that is useful to present potential investors and creditors making rational investment and credit decisions. Within the firm, accounting information is essential for the purposes of efficient managerial decision making - as

³ According to: Neely, A., Mills, J., Platts, K., Richards, H., Gregory, M., Bourne, M., Kennerley, M. (2000), Performance Measurement System Design: Developing and Testing a Process-Based Approach, International Journal of Operations & Production Management, Vol. 20, No. 10, pp. 1119-1145.

⁴ Kaydos, W. (1999), Operational Performance Measurement. Increasing Total Productivity, St. Lucie Press, Boca Raton, Florida.

managers need timely and accurate information in order to carry out the budgeting process and implement effective control mechanisms.

Financial accounting is regulated in national or international set of laws. Because of that, companies have marginal influence to these regulations, however, no zero-influence. They are obliged to obey the law. As the whole economy, state regulations evolve and are adapted to present business situations.

Management accounting

Management accounting has been practiced since 19th century (or even from the dawn of history in much more primitive form). During that time business environment has been constantly changing, sometimes even dramatically. Following that, also rules, methods of accounting, government regulations, measurements and management of company performance has also changed.

At early days of managerial accounting performance management was focused on physical assets, financial aspects and financial indicators. During years many methods were developed covering many areas such as accounting rules, cost calculation methods, financial statement analyses, profitability measurement and others. All of them are commonly known, deeply explored and described in literature and in practice.

Budgeting

Budget traditionally is a core element of measurement system of almost each company while it allows summing up the whole company performance in few indicators. Performances are usually measured by output (cost or expenses), inputs (revenues) and profitability. The budget process should begin by assuming a given level of sales unit (or sales income) and to determine reasonable level of output, however, sometimes it is done by opposite way.

Budgeting has a rich description in literature and in practice. Many methods of budgeting and cost calculations are available (e.g. functional budgeting or profit-centers budgeting, Activity Based Costing).

Budgeting maybe treated as a main tool of management system of the company. It should be also linked with company strategy while it may have been used as strategic management tool, used in each steps (analyse, implementation and control).

2.2 Main features - discussions

Intangible expenses – cost or asset?

As described in previous chapter new economy is more and more based on intangible assets. Conventional accounting performs particularly poorly with internally generated intangibles such as R&D, brands and human capital – one of the most important items, considered as engines of modern economic growth. Accountants (GAAP no. 38) generally agree that any internally generated intangibles should not be treated as an asset. On the other hand, if intangibles are created outside operations of a business, (are bought or ordered - such as purchased licensing agreements or franchises), they may be classified as an asset, and valued at market (or purchased) price. For example, today's generally accepted accounting principles classifies the immediate expensing of R&D as costs. But, unlike other costs (rent or interest payments), intangibles investments may often produce significant future value (why else would firms invest in them?). Expensing them now produces serious distortions in reported earnings and detracts from the relevance of financial reports. It obliged companies to decrease its yearly financial result by treating as costs investments in intangible and thus it do not allow to treat it as an asset and to put it in balance sheets as a company value.

Time referring, focusing on financial results

Traditional performance management solutions, especially accounting and financial reporting, are perfect tools referring company's performance in past. They provide deciders important information with significant delay. One year, as period that is still often applied to construct budget in many companies, may appear to long, in frequently changing environment, to correct the way project or

company going to. This problem may be illustrated as "driving motor car solely by looking through the rear view mirror (and a mirror that provides only an imperfect reflection, at that)"⁵

Budget process and management accounting focuses only on financial results. What is even worse it does not try to explain what the reason of those results was. However, these results are easily comparable to performance from previous years as well as to performance of other companies in the same sector, other sectors, other countries and internationally. Thanks to possibilities of consolidation we can compare competitors, sectors, economies and the global economy.

Traditionalism – availability of frameworks of measurement systems

Traditional tools are experiencing for decades. Thanks to that, many different approaches to performance measurement and management systems has developed and may be implemented in many different (even innovative) areas of businesses and non-profit organizations. Managers may select from many methods and frameworks that are deeply described in literature, professional journals and practiced in many organizations. Moreover, it may also implement proofed solutions by looking around and finding competitors or other benchmark that successfully works. Many specialists are available on the labour market that have experienced more then one implementation of traditional measurement system. Fact that traditional management accounting (company controlling) is commonly practiced is one of its strong point.

Standardization

A significant role to standardize accounting methodology of preparing and presenting financial statements of companies plays The International Accounting Standards Committee whoso one of the objectives is to prepare Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

"The International Accounting Standards Board is an independent, privately-funded accounting standard-setter based in London. The Board members come from nine countries and have a variety of functional backgrounds. The IASB is committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. In addition, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world"⁶.

In May 2000 The International Organization of Securities Commissions (IOSCO), advised its members to allow companies and other organizations to use „Standards 2000“ during preparing and presenting financial statements of Public Limited Companies (in its quotations and its offers). In February 2001 European Commission announced that all Public Limited Companies from European Union as well as banks and insurance companies (about 7000 companies altogether) should prepare its consolidated financial reports according to Generally Accepted Accounting Principles latest from 2005.

Implementing GAAP and IFRS standardized the way the financial results are calculated and presented. It simplifies not only compression results among countries, consolidation of conglomerates, increase its credibility but also define some standards. Any analysts reading financial report that is prepared according GAAP and IFRS know exactly what method was used to valuate assets or how the profit was calculated. However, despite many regulations and rules of accounting that companies must obey to present true and fair view of its activities its is common know that some of them are presenting its picture in much more brilliant then it really is. Few years ago many spectacular bankruptcy took place (with the most famous one – Enron case). It reveals that so-called creativity account is still up-to-date.

Is it enough to have a traditional system?

Despite of new trend of the global management concerning "new economy" traditional, financial approach is still very important tools of measuring and managing companies' performance. It is main tool to measure historical performance and presents results that reflect main aim of companies existing – to give the answer how much company has earned this year! What is my return of investment, did I manage to obtain better results then others.

⁵ David Otley, *Performance management: a framework for management control system research*, Management Accounting Research, 1999, 10 pages 370

⁶ Mission Statement of The International Accounting Standards Bard, <http://www.iasb.org/about/index.asp>

Some companies exist and they do not implement any other performance management system exceeding obligatory by the low. Some other run its books but parallel have a special department that are responsible for giving to management important financial information that are necessary for a day-by-day operation decisions as well as strategic one. Only “big” companies are able to create, implement and run complicated management systems that measure not only financial, historical performance but also try to use its measurement framework to predict future.

Having good planned traditional measurement system in some branches, where intangible assets do not play important role in creating value may save money, while extra measurement costs or implementing a sophisticated system may not pay-back.

3 New performance management tools - management models

3.1 New performance management tools- short overview

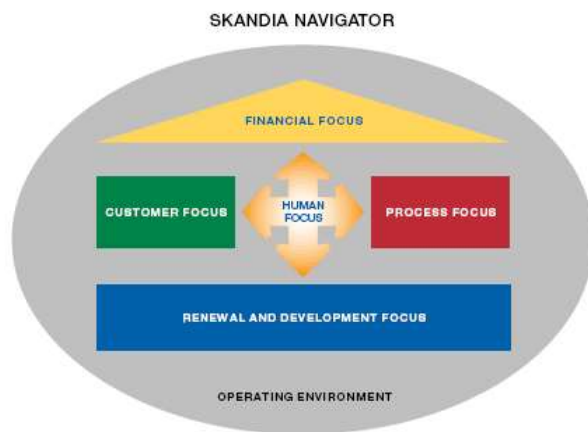
Measurement of intellectual capital - Skandia Navigator

On the basis of above classification Skandia developed an IC assessment tool called the Skandia Navigator. It is significant that Skandia is the first company that has implemented management system of intangibles assets.

Skandia defines five areas on which it focuses its measures and management: financial, customer, process, human, renew and development.

Financial focus contains data and indicators that basis on historical performances and are similar to the traditional concept of performance management.

Process and customer part regards to present companies activities. *Renewal and development* indicators measure how company is prepared to the future activities. In the middle of the model its authors put human resources that combined all areas.



The Navigator incorporates many indicators in the various areas, which are monitored internally on a yearly basis. The key (as a sample) indicators for customer, process, human and development are presented in table below.

Source: Visualizing Intellectual Capital in Skandia. Supplement to Skandia’s 1994 Annual Report, page 7

Table 1 Key Skandia Navigator Indicators.

Table 3 Skandia Navigator’s indicators - samples

| Customer focus | Process focus | Human | Development/renewal |
|-----------------------|----------------------------------|------------------------------|----------------------------------|
| Number of account | Number of accounts per employee | Personnel turnover | Satisfied employee |
| Number of brokers | Administrative cost per employee | Proportion of managers | Training hours |
| Number of customer | | Education costs per employee | Marketing expense/customer share |

Source: Visualizing Intellectual Capital in Skandia. Supplement to Skandia’s 1994 Annual Report,

Some critics

Although Skandia made a significant contribution towards raising awareness of IC it may be difficult to implement it to other companies (it was developed specifically for Skandia by their

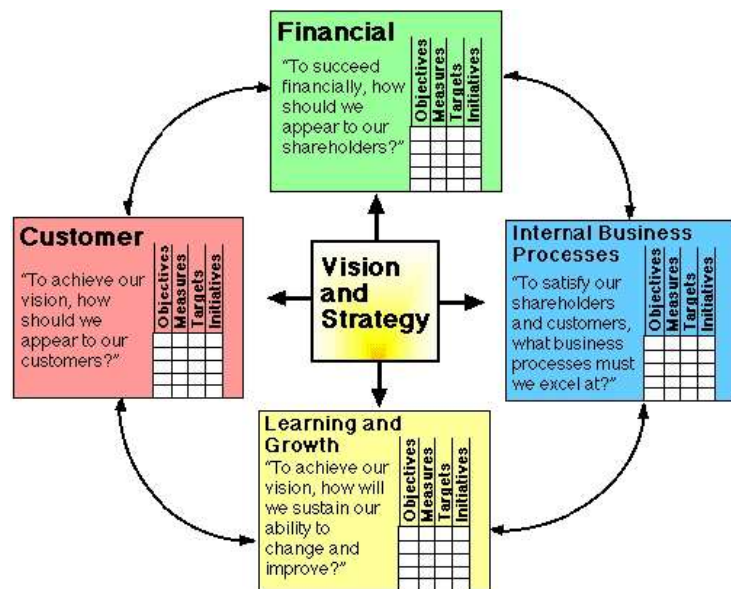
specialists)⁷ , although it was implemented by Swedish Government and was developed by other companies.

The main critics Valuation of intangible assets is based on the market value approach. Market value may be easily calculated (in fact is calculated each day when stocks are trade) only for those companies that are listed on stock exchange. Regarding to this companies market valuation is not such easy and results may be different depending on what method was used. It concerns especially Poland where stock market is no so much developed. Skandia Navigator indicators are also criticized by their subjectivity. Most of the indicators are subjective, are developed especially for one, particular company and may not be implemented by other corporations. Because of that indicator are not comparable along branches, sectors or globally.

The Balanced Scorecard – Harvard School model

The Balanced Scorecard (BSC) is an organisational framework for implementing and managing a strategy at all levels of an enterprise by linking objectives, initiatives and measures to an organisation’s vision and strategy

The BSC translates a business’s vision and strategy into objectives and measures across four balanced perspectives - financial performance, customers, internal business processes, and organisational growth, learning and innovation. Put simply, a BSC is a structured way of communicating measurements and targets, and is becoming a widespread way of how to manage, measure and communicate the financial, non-financial and intangible assets of a company. The BSC allows an organisation to monitor both its current performance (financial, customer satisfaction and business process) and its efforts to improve processes, motivate and educate employees and enhance its ability to learn and improve. The BSC is closely related to the concept of intellectual capital and comprises not only tools for the measurement of intangible resources but also a vision of continuous learning and change as to create value for the future. Since being introduced in 1992, the balanced scorecard concept has been implemented at the corporate, strategic business unit and even individual level in hundreds of public and private sector organisations worldwide.



The MERITUM model – a European approach

The Meritum Guidelines describe how companies can identify, measure and report their intangibles. The Guidelines suggest that measurement and management should be made in 3 phases i.e. the identifying, measuring, and monitoring phases. The Guidelines suggest that reporting, named IC Statements should cover a vision of the company; a summary of intangible resources and activities; and a system of indicators. The Meritum Guidelines have been developed in a collaborative project funded by the EU Commission, involving researchers from four Nordic countries and two other European countries.

The Meritum Model defines Intellectual Capital as the combination of the human, organizational and relational resources of an organization.

⁷ Libovitz and Wright (1999) criticized Skandia Navigator as it was developed only for Service company.

1. *Human Capital*: refers to the knowledge of the employees of the firm and the capacity to generate this knowledge. The Human Capital is the base for the generation of the other two types of Intellectual Capital. The Human Capital does not belong to the company. It is "hired" by the company for a period of time.

2. *Structural Capital*: it comprises the information and communication systems, the management systems, the patents and everything that helps the knowledge of the company to be systematized and makes it internal and explicit. The Structural Capital belongs to the company, it remains within the organization when the employees leave. A solid Structural Capital helps in a better flow of the knowledge and it improves the efficiency of the organization.

3. *Relational Capital*: it refers to the value that has for a company all the external relationships. The quality of the relationships and the ability to create new customers are key factors for the success of a company. It is also a very important knowledge spring, the relations held with other agents such as the suppliers and the different alliances of the company.

The MERITUM Model uses blocks in where the different elements composed by intangible assets are grouped. In order to measure those intangible assets there are different indicators. Some of them are presented in table below.

Table 4 Meritum Model's Indicators - sample

| INTANGIBLE | INDICATOR | type |
|--------------------------------|---|-------------|
| Highly trained people | % of employees with a high education, intermediate, basic school | NF |
| Training activities | a) Total number of training hours received by managers to total training hours b) Total training cost per key employee | NF F |
| Survey of employees | c) Average employee satisfaction with competence development a) Average satisfaction of the employees with the training activities b) Cost of the survey | NF F |
| Patents | c) Average satisfaction with leadership | NF |
| R&D activities | Number of patents registered over the last year | F |
| Analysis of R&D rate of return | R&D expenditure | F |
| Loyal customers | R&D as a percentage of turnover | NF |
| Survey of customers | a) % of long-term customers (5 years or more) to total number of customers b) % of turnover due to long-term customers a) Average satisfaction of the customers with the company's products and services b) Cost of the survey | F NF |
| Job rotation | c) Average satisfaction with meeting company representatives % of workforce to rotate their job every year | NF |

Source: Meritum Project, Final Report

Measuring accurately the cost of any intangible activity and assessing its impact on the company's performance indicators (such as market share, turnover, earnings, market value, etc.) – although desirable – appears to be a very difficult task.,

Firstly it is not always possible to associate a cost with each intangible activity.

Secondly, the impact of a particular intangible activity on future performance may only be reliably when measured in exceptional cases (for example the effect of R&D expenditure on patents –these two indicators are in fact directly related).

Using the Meritum approach will bring into focus how the company – through the connectivity of critical intangibles in a network –pursues its strategic objectives and by this focus on how to create value for users and other stakeholders.

Economic Value Added (EVA™)

EVA (economic value added) is a measure developed in the 1980s by New York consultancy Stern Stewart & Co as an indicator of returns to shareholders. EVA strips out many of the anomalies of the accounting system, and represents the difference between profit and the cost of capital. It provides a measure directly linked to return on capital employed. In simple terms:

$$\text{EVA} = \text{net operating profit after taxes} - (\text{capital} \times \text{the cost of capital})$$

Put most simply EVA is net operating profit minus an appropriate charge for the opportunity cost of all capital invested in an enterprise. As such, EVA is an estimate of the amount by which earnings exceed or fall short of the required minimum rate of return that shareholders and lenders could get by investing in other securities of comparable risk. By taking all capital costs into account, including the cost of equity, EVA shows amount of wealth a business has created or destroyed in each reporting period. The related measure MVA (market value added) compares total market value (less debts) with the money invested in the firm, represented by share issues, borrowings and retained earnings.

According to Stern Stewart, conventional financial balance sheets often need restating to give an accurate picture of the capital employed in the business, and often this involves adding in intangibles. They have identified over 160 possible balance sheet adjustments, of which an obvious one is to write back goodwill that has been written off. Other adjustments may include adding back R&D costs, and appropriate parts of marketing expenditure as well. If this was not done the EVA would show a short-term reduction even though the investment may ultimately increase the MVA. Despite its popularity, measures like EVA have numerous critics.

First, among analysts there is a feeling that EVA relies too much on accounting profits and adjustments, whereas cash flows might be a more reliable indicator. Analysts are beginning to recognise that EVA should be complemented with measures that created stronger linkages between long-range plans, financial and stock price goals.

Critics also argue that EVA is still too historic a measure and does not provide any sense of the linkages between a company's investments in intangibles and its financial performance. Furthermore, EVA has also been criticised for its inability to explain why firms can be successful one year and then a complete failure the next.

EVA and the like is all well and good, but there is absolutely no evidence whatsoever that it is a guide to whether companies can sustain good performance. What we are looking for are the measures which really create shareholder value over the long term.

3.2 Main features - discussion

An attempt to measure intangibles

One of the strongest point as well as main purpose of inventing new approaches to performance management is an attempt to measure intangible assets of the company.

Traditional accounting does not perform so well, when companies put their investment in intangibles (e.g. some innovation product, for example to open up a new market). It is hard for investors and accountants to value this additional investment, particularly because the future earnings it might generate are so uncertain. Traditional tools find it particularly difficult to cope with fast moving industries, with rapid innovation which is driven by investment in intangibles.

Traditional accounting techniques do an unacceptable job of measuring the value of the principle activities of a knowledge-intensive business. According to conventional accounting practices, tangible acquisitions such as computers, land and equipment are treated as company assets. Investment expenditure on knowledge-building activities such as training and R&D are, however, still largely treated as costs. This is despite such activities being a primary source of organisational wealth in the new economy.

Interest in accounting for intangibles is based on the assumption that the present non-accounting of intangibles is causing harmful effects. Supporters for the inclusion of human capital and structural capital into the balance sheet argue that such capitals may largely explain the gap between book value and market value. Opponents argue that balance sheet is not designed to be speculative and that determining precise figures/numbers are highly subjective and difficult to measure. The main argument for accountability and accounting regulation is (capital) market failures, e.g. appropriate accounting regulation would reduce the amount of market failures. If intangibles are not reflected in the balance sheet, and intangible investments are fully expensed as they are undertaken, both earnings and the book value of equity are argued to be understated by the conventional accounting model. This makes it practically impossible for investors and company managers to:

- assess the rate or return (productivity) of investment in intangibles, and changes over time in the efficiency of the firm's investment activity;

- evaluate shifts in the characteristics of intangible investments, such as from long-term research to short-term development, or from product development to "process (cost reducing) R&D"; and
- determine the value of a firm's intangible capital, and the expected lives (benefit duration) of such assets.

There is considerable evidence that this lack of information about asset and true sources of value in corporations is already an urgent problem for corporate investors and managers. However, because valuation and disclosure issues related to intangibles are complex and little understood, accounting standard-setters around the world encounter great difficulties in attempting to improve disclosures about intangible assets

Multidimensional approach

Multidimensional approach to measurement of performance is undoubtedly a considerable step forward. Despite the fact, it gives many measures that may be slightly confusing, it does not focus on particular indicator – financial one. That may give a broader view of company's results, may describe deviations or justify enormous drops or falls. Thanks to that some financial results, that would be difficult to clarify maybe, however, do not have to be, described in details.

Thanks to using qualitative and quantitative measures in many company's perspective some sophisticated methods (especially BSC) developed from measurement tools to the company strategy management system.

Time consuming

Creation of some new "balanced" model needs involvement of considerable amount of time of the project team as was as on the part of everyone whose performance is to be measured. Usually companies that are about to implement new performance management system need to start from almost zero level. The selection of appropriate measures for the four perspectives can be especially time consuming. This is due to that fact that in any company there are a large number of potential goals and targets, and even more ways to measure them. People are likely to disagree about which objectives should be measured and how to measure those objectives. It obvious that it will take time until consensus is achieved.

Too many measures

Companies using "new" methods often come up with too many measures. For example, a division of one company came up with 500 important measures for its scorecard on the first pass. This is a problem because it is very difficult to accurately track a large number of measures. When using too many measures it is difficult to focus on each of them. Thus this some relevant information or signal about futures may become oversighted.

No external comparison

New models are usually in some aspects innovative and specific. Its specifics are caused by the fact that literature provides only general framework of the systems. Details must be created inside the firm. Implemented measures are usually specific only to the sector company operates. That's way most (if not any) cross-companies comparison are possible. This, unfortunately significantly narrows the utility of the data. It is hard to asses one indicator of company X with similarly sounding indicator in firm Y while they may only sound similarly. Because of that it is hard to judge if the company performed better then competitor or not. However, it is possible to compare performance annually and in fact, e.g. Balanced Score Card was created as an internal document so it maybe treated not as a disadvantage but rather as an assumption.

Participation and commitment of staff

Even well-designed scoreboard will be useless without the participation and commitment of staff in implementing and using it. Contrary to traditional control systems where special departments are responsible for controlling, here staff is responsible for collecting data and putting them into the system. That's why it is so important to make responsible people to keep motivating and participating in the process. In some cases it may appear not as easy as it firstly appear.

Unfortunately, accounting for intangible assets is more easily described than implemented. It is a new discipline, as yet largely undeveloped. There are clearly difficulties in quantifying immaterial attributes such as openness to change or even degrees of competence. As a result of the numerous problems associated with traditional financial measures of intangible assets -there is general

agreement that new types of measurement systems are needed that will help investors, managers and policy-makers alike manage more effectively in the knowledge economy. The problem is recognised internationally, and a number of countries are working on developing a workable system of accounting for intangible assets

4 Summary

We live in the world of measures and indicators. In organizations appear more and more sets of indicators that are not only related to financial aspects. Companies try to increase the number of non-financial and intangible indicators from several past decade. They do so, because in some aspects of running a business, some business phenomenon not always may be precisely valued or described by "raw" numbers. This is caused by the increasing role of intangible assets in new, knowledge based economy. How company, that its main value are intangibles may manage it and provide information to its stakeholders using traditional accounting tools, that very often do not take them into consideration?

Presently companies may choose between implementing a new ways of measuring its performance or use traditional one. Maybe some new approaches are much more subjective, they do not provide relevant flexibility and sometimes are tailor-made particularly to the one company, are incomparable among companies, operating even it the same sector, but they are and they provide information! Of course, a lot must be done regarding to new ways of measurement especially in terms of standardization and further development. It should be also considered if new-economy firms should not be obliged to presents some "intellectual capital supplements" to their financial reports in case to provide sufficient information to their investors.

Both methods has its pros and cons. Implementation of the new model maybe sometimes difficult, time and money consuming but if we based our value on intangibles do we really have a choice? No, we don't! We must measure it *while what is measure is what we get.*

5 References

1. "INTELLECTUAL CAPITAL ANALYSIS AS A STRATEGIC TOOL" - Strategy and Leadership Journal, July/Aug 2001. Vol 29. Nr. 4, pp21-26 Intellectual Capital Services (ICS) Ltd. 46 Gray's Inn Road London
2. Anti Lonqvist *Measurement of Intangible Success Factor – Case Study on the design, implementation and use of measure –*, Tampere University of Technology, Publications no. 485
3. Bino Catasús, Jan-Erik Grujer, Jiri Novak The Capital Market's Intellectual Capital
4. Bogusław Skuza "Management of intellectual capital – Skandia Group" – Presiden of Skandia Live Poland, Publishing of MBA 1/2002
5. Jan-Erik Gröjer *Intangibles and Accounting Classifications: in search of a classification strategy*, School of Business, Stockholm University
6. Kaydos, W. (1999), *Operational Performance Measurement. Increasing Total Productivity*, St. Lucie Press, Boca Raton, Florida
7. Parkiet.com - Warsaw Stock Exchange newspaper
8. Robert S. Kaplan, David P. Norton *Putting Balanced Scorecard to Work* Harvard Business Review, product number 4118
9. Robert S. Kaplan, David P. Norton *The Balanced Scorecard, Measures that drives performance*, Harvard Business Review, Reprint 92105
10. Skandia *Intellectual Capital Report*, Skandia 1994
11. Warsaw Stock Exchange – "Cedula Gieldy – on official report of quotations
12. Meritum Project "GUIDELINES FOR MANAGING AND REPORTING ON INTANGIBLES (INTELLECTUAL CAPITAL REPORT)", June 2001