January, 2009

TRENDS IN THE NETWORK OF BUSINESS PERFORMANCE: A THEORETICAL AGENDA

ThankGod C Agwor, Dr

Available at: https://works.bepress.com/thankgod_agwor/9/
INTRODUCTION
In our theoretical formulation, we presupposed that business performance is influenced by the internal audit function. Thus, having discussed internal audit function and its dimensions in the foregoing, we now discuss business performance with regard to its measures such as profitability, effectiveness and efficiency. Business performance means the record of achievements made by an organization over a given period. The parameters or measures of performance in business are sourced from both organizational strategies and objectives. There has been raging controversies on how business performance can be measured. This controversy is evident from the existence of diverse approaches, measures and concepts of business performance.

APPROACHES AND MEASURES
The financialists’ proponent of business performance emphasizes objectives and goals, covering such areas as financial measures and reporting performance. For them profitability which covers output volume and growth is the best measure of business performance. For instance, Daft (2001) advanced that profitability reflects the overall performance of profit making organizations. Profitability may be expressed in terms of net income, earnings per share or return on investment. Other overall goals are growth and output volume. Growth pertains to increases in sales or profits overtime. Volume pertains to total sales or the amount of products or services delivered. Thompson and Strickland (2001) considered the financial measures of C performance necessary a rid important. According to the authors, achieving acceptable financial results is crucial. Achieving acceptable financial performance is a must; otherwise the organisation’s
financial standing can alarm creditors and shareholders, impair its ability to fund needed initiatives and perhaps even put its very survival at risk (Thompson and Strickland 2001).

The dominant holistic approach to business performance measurement is the balanced scorecard introduced in the nineties by Kaplan and Norton (Aderibigbe, 2001). The scorecard draws attention to core issues and opportunities in business performance measurement, contending with two key issues, such as how do we know and what moves us to act?, which Kotler (1990) described as the dominant framework in use today. A few scholars have been critical about the views expressed on the balanced scorecard. Scholefield (2005) argued that because the balanced scorecard provides an excellent conceptual overview and framework for performance measurement, but does not provide a methodology, for developing, implementing and maintaining a performance system, despite its strength, that it is limited as an approach to performance measurement. Since methodology is lacking, the absence of step-by-step approach to measuring performance, the way of its application to diverse performance measures have become a matter of common practice. For instance Barrie (1974) observed that the common ways to designing performance measures are limited despite the perceived strength. According to him, the selection of performance measures is usually done through fast routes such as brainstorming, benchmarking, using existing data, measuring what stakeholders want measured and listening to industry experts with considerations of their drawbacks (Baffle 1974).

Concerted efforts are still ongoing to introduce more or better approaches to or indicators of business performance, either financial or strategic performance. However, a tested framework overtime, is that which uses the concepts of Effectiveness and Efficiency. Stoner et al. (2002) advanced that Peter Drucker was the first scholar to introduce the concepts of effectiveness and efficiency as measures of performance, either for the individual, group or organization. They described
organizational performance as the measure of how efficient and effective an organization is, dovetailing to how well it achieves appropriate objectives. Efficiency can be defined as the ability to minimize the use of resources in achieving operational objectives: doing things right while effectiveness is the ability to determine appropriate objectives: clomg the right thing.

The performance theory development provides opportunity for redefinition of the link between financial development and business performance (Hondroyianis, 2004). A widely held notion is that financial development can affect the rate of business performance, if productivity and the efficiency of capital is not sustained. It has also been shown that financial development affects the accumulation of capital through its impact on the savings rate or by altering the proportion of saving (Pagano, 1993 and Levine, 1997). However, the theoretical issues are not yet resolved as empirical research and policy direction on the relationship between financial development and business performance have not been subjected to much systematic assessment.

Abiola (2003) argued that the banking industry seems to be in the forefront of the quest of achieving very effective business performance especially in developing countries, where electronic-banking has fast become a handy criterion for assessing the performance and viability of the bank. Efficiency and profitability are among the variables for assessing the performance of banks. The study, sought to examine, the effects of information systems on the business efficiency and profitability of Nigerian banks. The findings of the study showed tremendous effects on the efficiency of banks, which in turn, has positive effects on customer satisfaction, leading to higher profitability. Therefore, business performance could be relatively enhanced, by extension.

**PROFITABILITY**

Having discussed business performance in the previous section, here we discussed business profitability, effectiveness
and efficiency as related measures of business performance. In this context, profitability refers to gaining a material advantage, positive assessment of volume or value of improvement in course of the operations of the organization over a given period (Penrose, 1959). Penrose (1959) has argued that all business operations have a growth potential. The desire to grow in addition to the pursuit of ‘profits’, is a prerequisite of business performance. From the foregoing, profitability appears to be a very significant dimension of business performance.

Penrose (1959) has further argued that profitability is an essential element of business performance. Therefore, profitability could be considered as, the principal goal of every business organization. It is achievable through earning a satisfactory gain at an acceptable level of risks. Thus profitability refers to profits in the long run rather, than within a current operational period, because of the fact that many current expenditures reduces current profits, but increase long-run profits. The expenditure in question includes advertising and research and development. Govindarajan and Anthony (1995) argued in their study of General Electric Company, that the company should not venture into any business in which its sales revenues were not going to rank top most in the industry. Welch (2003) corroborated the view in the study of General Electric Company, that the implication is that, if the company has the highest market share in an industry, the profitability-associated elements of revenues, expenses, investment and their effects on returns on investment can be satisfactorily controlled.

Wilson (1986) argued that profitability is not about cash flow or expected returns on investment. The assertions prompted a number of subsequent studies, such as Bowen and Daley (1987), Lee and Fielding (1996), Vickrey and Bettis (2000). The profitability concept refers to the tendencies of profit making in alternative courses of action or decision; (Flaboya, 2005). According to Okolie (2006) while differentiating profit and profitability, reflected on buttressing Flaboya (2005:87),

argued that profit is an absolute measure of the overall amount of net income earned in a transaction, by a business organisation.

Profitability can be judged from the net return as well as the cost savings of alternative transaction. In the concept of profitability, it is not enough that a company knows that it is making profit. It also needs to know if it is making as much profit as it could. While in theoretical studies aimed at maximization of profit, it is accepted that perfection is rather impossible to attain in practice and this often requires very practical test. These tests can be regarded as the test of profitability and consist of test of possible cost reduction and net return improvement through either increase in sales of production or increase in production mix. Such test includes inter-firm comparisons and a more detailed audit into the cost and revenue implications with the following concept and techniques, profit, cost data analysis and the concept of added value and contribution (Okolie, 2006).

The accounting concept of profit is derived from net business income normally resulting from the sales transactions of the organisations. The sales transaction of any period brings new assets into the business in exchange for those within the business enterprises (Flaboya, 2005). Profit result from evaluation of the assets in the market and marketing bargains. The profits a company earns are the reward from many activities carried out in the company. The profit to an enterprise is a necessity of survival from which ranges are taken care of, investors expects their returns, and expansion takes place from the profitability of a firm, the workers determine their employment livelihood and their income because to them as workers, profit is somebody else’s income. The organization should operate at an adequate profit. This is the first social responsibility as well as its duty toward itself and its workers.

In consideration of the purpose of profit, profit is used as an index to measure performance. It measures the net
effectiveness and soundness of business efforts. It is the ultimate test of business performance (Van Home, 1997). It is the risk premium that covers the cost of staying in a business, replacement of obsolescence, market risk and uncertainty. As asserted by Brigham (1983), profit ensures the supply of future capital for the innovation and expansion either directly by providing the means of self-financing out of retained earnings or indirectly through providing sufficient inducement. It provides an objective statistical or quantitative evidence or profitability in alternative transactions and showing their alternative transactions by showing their absolute profit margin quantitatively. It is relatively easier to know a more profitable alternative transaction, some scholars provided a deeper, insight into the usefulness of measuring profitability with profit and others maintain that profit is in most cases, is the ultimate objective of an organisation. Like all other objectives, target level can then be predetermined and planned, using the relevant variables selling price, volume and product mix combination.

If profit is the residual of a business process, it is likely, to be one of them and hence will not have any significant bearing on how fairly, tasks have been performed. On the other hand, if it is the ultimate objective, it represents performance and can be explored through these variables. These variables are then the micro constituents of profit making potentials in alternative strategies. When this approach is adopted, profitability can be measured by the relative efficiency in the choice and combination of the principal variable that affects absolute profit margin (Flaboya, 2005). On the whole, the concept of profit as a measure of profitability will suffer.

The problem associated with profitability measurement is not, however, what should be measured. It is what measurement yardstick to adopt. When profit is measured on a percentage of sales, it will not indicate how vulnerable a product or business is to economic fluctuation. In such circumstance, a breakeven point analysis is often preferred. The alternative yardstick could be return on invested capital. Though, this
makes sense, but it is still not a very good yardstick, because from return on invested capital, the following question will usually arise. What is invested capital? Is capital to be defined by the accountant as original cash value, less subsequent depreciation? Or is it to be defined by the economist as wealth producing capacity, in the future, discounted at capital market interest rate or at current cash value? Both definitions may fall short of the expectation.

PURCHASING POWER AND BUSINESS PERFORMANCE
According to Okolie (2006) the accountants’ perspective, did not provide for changes in the purchasing power of the currency and changes in technology. It does not permit any appraisal of business performance, because it does allow the following: (1) the variation in risk of different businesses into account; (2) comparison between different businesses; (3) comparison between different components of the same company; (4) for comparison between the old plants and the new plants, and (5) it tend to encourage technological obsolescence. The economist concept of invested capital is theoretically perfect. But it cannot be used in practice. It is literally impossible to figure Out, how much future wealth producing capacity of any investment in the past represent today. Therefore invested capital, could be described as the amount it would cost today to build a new organisation, new plant, new equipment and the same productive capital as the old organisation, plant and equipment. Theoretically, this also have weakness, because it would for instance, greatly distort profitability in a period of depression when new equipment prices and building costs are low. But the main difficulties are practical since placement assumption, besides being not too reliable, are difficult to make and even minor changes on the assumed basis will lead to wide divergence in the end results.

CONCLUSION AND IMPLICATIONS FOR ORGANISATIONAL EFFICIENCY AND EFFECTIVENESS
In the organizational context could be conceptualized from the goal optimization model Mintzberg (1979) argued that the
success of organization is measured against organizational intentions, as against a researcher or an investigator’s value judgment. In the same regard, Daft (1995) argued that, effectiveness is the organization’s capacity to acquire and utilize its scarce and valued resources as expeditiously as possible in the pursuit of the operative and operational goals. It is evaluated in terms of how well an organization can attain its feasible goals. Perhaps, this has made Steers (1977) to argue that management plays crucial role in the ultimate determination of overall organizational effectiveness.

Effectiveness refers to the accomplishment of objectives; an example of effectiveness is the production of parts without defects. Before an internal audit for effectiveness can be performed, there must be specific criteria defining effectiveness. An example of an internal audit for effectiveness would be to assess whether a governmental agency has met its assigned objective of achieving elevator safety in a city. Before the internal auditor can reach a conclusion about the agency’s effectiveness, criteria for elevator safety must be set. Is the criterion that all elevators in the city be inspected at least once a year? Is the criterion that no fatalities occur due to elevator breakdowns or that no breakdowns occur? Such criteria for effectiveness usually include objectives and goals that specify the mandate of the organization.

The concept is a measure of the cost of resource associated with goal accomplishments, or outputs realized compared to inputs consumed. It also refers to the resources used to achieve objectives. Efficiency is concerned with whether the units produced, were at minimum cost. The measure of equipment utilization, facilities maintenance, and returns on capital employed are all efficiency criteria. In an efficient situation, like effectiveness, there must be defined criteria for what is meant by performing more efficiently before internal auditing can be meaningful. It is often easier to set efficiency criteria than effectiveness criteria, if efficiency is defined as reducing cost without reducing effectiveness. If two different production processes manufacture a product of identical
quality, the process with the least cost is considered more efficient. Efficiency is always determined by looking at input in relation to output.

In terms of resource utilization and efficient manager is one who meets the daily production quota at minimum cost (Williams, 2001). True managerial success entails both effectiveness in goal attainment and efficiency in resource utilization. According to Katz and Kahn (1999) efficiency is the ratio of inputs to outputs. They argued that economic and technical solution to organization assist in economic transformation of energy which contributes to organizational survival and growth. To critically assess efficiency, because of its inherent complexity, Olayiwola (2002) argued that there should be checklists of good practices, whereby reviews would be built up from a detailed knowledge of cost effective practices. Thus, it is necessary to undertake a small number of specific investigations into activities with high cost, and poor performance measures to identify the appropriate remedial action.

The measures of effectiveness and efficiency are indicators of organizational performance, which is the quantity and quality of output from the individual or group doing a job, with respect to the task expectation. This implies that, in the management of organizations, management recognizes that internal auditors achieve personal satisfaction from the duties assigned to them. The creation of favourable work environment that makes internal auditors achieve satisfactory performance tends to lead management to discovering the meaning of commitment in the work place, to internal auditors.

The internal auditor possesses reasonable degree of independence on the assigned responsibilities, the major hallmark about the expectation surrounding the duties, would facilitate unhindered access to all managers and executive directors, thus, there should be relative satisfaction on the job. Internal auditors with high performance rating are the
cornerstone of high productivity and enhanced growth in organization. Though, satisfaction is of recognized psychological importance to the internal audit unit, it is also a sure component in the quality of work life, in general. Therefore, it is easy to argue that management of organization should seek to create job satisfaction, among their subordinates at the internal audit department, regardless of the fact that there is no guarantee that highly satisfied internal audit staff will bring about high performance in the overall assessment of the organization’s operations (Steers, 1977 and Olayiwola, 2002).

Considering that the difference between revenue and expense is income, both private and public sector organizations’ expenses can be measured, though more accurately in the private sector organization. Schermerhorn (1988), argued that though, revenue is not a measure of output, the absence of this parameter had led to the development of monetary indicators, which are classified into results measure, process measure and social measure. The result measure is output that is supposedly related to the organization’s objectives. The examples are number of students graduating from a university and number of kilometers of road construction work completed. They are rarely exact measure of output, since the number of graduates does not show how well the students were educated and the number of kilometers of road construction work completed does not tell anybody the quality of work done. The process measures are related to an activity carried on by the organization, they are useful in measurement of current, short-run performance. They are easier to interpret, because there is usually a causal relationship between inputs (costs) and the process measure. The process measures relate to efficiency, which is what was done and not whether, what was done helped achieve the organization’s objective. While process measure is means-oriented, result measures are ends-oriented.

The social indicator is a broad measure of output that reflects the result of the work of an organization, which also relate to
effectiveness. For example, life expectancy is an indication of the effectiveness of a country’s health care system, but smoking habits, dietary and standard of living, also affect life expectancy. These are of limited usefulness in day-to-day management, because of the effect of other external influences. The effectiveness measure of business performance is the relationship between a responsibility center’s outputs and its objectives, the extent to which the output of service meet the objective of the organization. From these measures of business performance identified in Katz and Kahn (1999), we shall further this discussion in some theoretical formulations that tend to relate internal audit function with business performance.

REFERENCES


