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Performance implications of strategic performance measurement in financial services firms

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Abstract

This study examines the relation between measurement system satisfaction, economic performance, and two general approaches to strategic performance measurement: greater measurement diversity and improved alignment with firm strategy and value drivers. We find consistent evidence that firms making more extensive use of a broad set of financial and (particularly) non-financial measures than firms with similar strategies or value drivers have higher measurement system satisfaction and stock market returns. However, we find little support for the alignment hypothesis that more or less extensive measurement than predicted by the firm's strategy or value drivers *adversely* affect performance. Instead, our results indicate that greater measurement emphasis and diversity than predicted by our benchmark model is associated with higher satisfaction and stock market performance. Our results also suggest that greater measurement diversity relative to firms with similar value drivers has a stronger relationship with stock market performance than greater measurement on an absolute scale. Finally, the balanced scorecard process, economic value measurement, and causal business modeling are associated with higher measurement system satisfaction, but exhibit almost no association with economic performance.

Introduction

Managerial accounting is evolving to encompass a more strategic approach that emphasizes the identification, measurement, and management of the key financial and non-financial drivers of strategic success and shareholder value (Institute of Management Accountants, 1999; International Federation of Accountants, 1998). In response, many firms are adopting strategic performance measurement (SPM) systems that (1) provide information that allows the firm to identify the strategies offering the highest potential for achieving the firm's objectives, and (2) align management processes, such as target setting, decision-making, and performance evaluation, with the achievement of the chosen strategic objectives (e.g., Gates, 1999; Otley, 1999).

Proponents of strategic performance measurement advocate two general approaches for developing SPM systems. The simplest approach calls for firms to measure and use a diverse set of financial and non-financial measures. Advocates of this "measurement diversity" approach argue that a

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broad set of measures keeps managers from sub-optimizing by ignoring relevant performance dimensions or improving one measure at the expense of others. As a result, these advocates claim that firms achieve higher performance when they place greater emphasis on a broad set of financial and non-financial performance measures (e.g., Lingle & Schiemann, 1996). A second approach is based on contingency theory, which argues that strategic performance measures must be aligned with the firm's strategy and/or value drivers (Fisher, 1995b; Langfield-Smith, 1997). Under this approach, performance theoretically is enhanced when "measurement gaps" between the firm's strategic priorities and measurement practices are minimized. Thus, performance is expected to be lower when the SPM system places either less or more emphasis on a measurement practice than the level required by the firm's strategy and value drivers.

Closely related to the contingency perspective is the use of measurement techniques such as the balanced scorecard process, causal business modeling, and economic value measurement. Advocates argue that these techniques help companies improve the alignment between their performance measurement systems and their organizational objectives (Gates, 1999; Kaplan & Norton, 1992, 1996, 2001; Stewart, 1991; Young & O'Byrne, 2001). Despite these arguments, the extent to which firms claiming to use these techniques actually link their performance measures more closely to strategic priorities is unknown.

Using data from 140 US financial services firms, we extend prior research on the performance implications of strategic performance measurement along several dimensions. First, we examine a broader set of measurement system uses (goal setting, capital investment decisions, identification of improvement opportunities and development of action plans, performance evaluation, and external disclosure) and measurement capabilities than prior studies that typically focus only on performance evaluation and compensation. Second, we investigate the relation between SPM practices and actual financial outcomes (accounting and stock returns) rather than relying exclusively on *self-reported* measurement satisfaction or firm performance. Third, we examine each of the SPM approaches and compare their relative ability to explain firm performance. Fourth, we extend prior contingency research by looking at the alignment between specific value drivers and measurement, in addition to the traditional alignment with firm or manufacturing strategy. Fifth, we provide evidence on the use and performance consequences of the three measurement alignment techniques (balanced scorecard, economic value measurement, and business modeling), an area that has received surprisingly little attention in the research literature. Finally, we examine potential lags between the implementation of performance measurement systems and economic results.

We find consistent evidence that SPM practices are associated with 1- and 3-year stock returns, but not with our two accounting measures (return on assets and sales growth). In particular, financial services firms that make more extensive use of a broad set of financial and (particularly) non-financial measures than those with similar strategies or value drivers earn higher stock returns. These results are even stronger in the subsample of firms with more mature performance measurement systems, suggesting that these measurement practices yield economic results with some lag.

We find little support for the hypothesis that more or less extensive measurement than predicted by the firm's strategy or value drivers *adversely* affect performance. Instead, our results indicate that *greater* measurement emphasis and diversity than predicted by our benchmark model is associated with *higher* satisfaction and stock market performance. These findings suggest that the average measurement practices of firms pursuing similar strategies or value drivers currently are not optimal in this industry.

We also find that greater measurement diversity compared with firms with similar strategies or value drivers has a stronger relationship with stock market performance than greater overall measurement. This evidence suggests that the appropriate benchmark for assessing measurement diversity is greater measurement *relative* to competitors with similar strategies or value drivers rather than greater measurement on an *absolute* scale.