

King Fahd University of Petroleum and Minerals

College of Industrial Management

Department of Accounting & MIS

ACCT 510: Managerial Accounting

MBA Program

Chapter 9 (Lecture Notes)

Performance Measurement and Compensation Schemes

Motivation and Goal Congruence

- Organizations spend a lot of time determining how to motivate employees
- When designing jobs and specific tasks, system designers should consider the following three dimensions
 - ✓ Direction, or the tasks on which an employee focuses attention
 - ✓ Intensity, or the level of effort the employee expends
 - ✓ Persistence, or the duration of time that an employee will stay with a task or job
- Goal congruence: the outcome when managers' and employees' goals are aligned with organizational goals (obtaining promotions, earning financial bonuses and advancing their careers)
- However, even if goals are aligned, organizations can not rely on employee self-control to achieve targeted performance.
- Organization often set up tasks: standard procedures that employees are told to follow

Management often relies on behavior controls

1.Tasks Controls

- Preventive controls: control focuses on an undesired event
- Monitoring: inspecting the work or behavior of employees while they are performing a task

How monitoring can be accomplished:

- Using listening devices or through surveillance

Negative Consequences:

- Monitoring causes unnecessary stress
- Undermining the level of trust between employees and employers

What situations in which tasks controls are necessary?

2. Results Controls: focuses on measuring employees performance against stated objectives using control systems

e.g: divisional profitability, sales performance against stated targets.

Results control is most effective when:

- Organization members understand the organization's objectives and their contribution to those objectives
- Organization members have the knowledge and skill to respond to changing situations by taking corrective actions and making sound decisions
- The performance measurement system is designed to assess individual contributions so that an individual is motivated to take action

The Need for Multiple Measures of Performance

(mix short and long-term qualitative and quantitative measures)

Balanced Scorecard Approach: a systematic attempt to design a performance measurement system that translates an organization's strategy into clear objectives, measures, and initiatives.

Built around four perspectives:

- The financial perspective: financial performance measures such as operating income, return on capital employed, and economic value added
- Customer perspectives: measures the business units's performance in targeted customer and market segment, e.g customer profitability, customer retention, customer satisfaction, and market share.
- Internal Business Process Perspective: focuses on those processes that will increase value to customers and lower costs for improved financial performance
- Learning and Growth Perspective: addresses three sources of organizational learning and growth
 - ✓ People: measures include employee satisfaction and retention, training, and skill development
 - ✓ Systems: to determine whether information systems are producing accurate, reliable, and consistent information that informs managers about their customers and business processes
 - ✓ Organization procedures can be evaluated by determining whether the organization has specific organization metrics of success with appropriate reward systems

Developing Appropriate Incentive Systems

1. Intrinsic Rewards: those rewards that come from within an individual and reflect satisfaction from doing the job and the opportunities for growth that the job provides

2. Extrinsic Rewards: Motivating desired behavior by providing an explicit, usually financial reward

Incentive compensation: reward system that provides monetary (extrinsic) rewards based on measured results.

Effective Performance Measurement and Reward Systems

Six Attributes

- Employees must understand their jobs and the reward system
- Designers of the measurement system must make a careful choice as to whether the system measures employees' inputs or outputs
- The elements of performance that the measurement system monitors should reflect the organization's critical success factors
- The reward system must set clear standards for performance that employees accept
- The measurement system should measure accurately performance
- When the activity measured relate to a group, the performance measurement system should reward the group

Types of Incentive Compensation Plans

Cash Bonus (Lump-sum reward, pay for performance, and merit pay): A payment method that pays cash based on some measured performance.

- *Is one-time award that does not become part of the employee's base pay in subsequent years*
- Cash bonus can be fixed in amount and paid when measured performance exceeds the target
- Can be proportional to the level of performance relative to the target
- They can be based on individual or group performance
- Can be paid to individuals or groups

Profit Sharing: A cash bonus calculated as a percentage of an organization unit's reported profit

- a group incentive compensation plan focused on short-term performances
- the scheme defines what proportion of the organization's reported profits is available for sharing, the employees who are eligible to participate in the plan, and the formula for each employee's share
- many profit-sharing plans are based on residual income (now called economic value added). In these plans, the reported profit will be reduced by some percent (say 15%) of the shareholders' funds in the organization. This share provides shareholders with required return on their investment. The remaining profit will be divided between shareholders and employees (e. 40% and 60%).
- Each employee's share of the profit may be based on a performance score
- Is an individual reward

Gainsharing: A system for distributing cash bonuses from a pool when the total amount available is a function of performance relative to some target, e.g employees receive bonuses when their performance exceeds a target

- A group incentive scheme (in a dept store)
- Provides for sharing in a form of financial gains
- Gainsharing promotes teamwork
- However, it requires employees to have the skills to participate in the scheme

Improsahre (improved productivity sharing): determines its bonus pool by computing the difference between the target level of labor cost given the level of production and the actual labor cost (the direct labor efficiency variance)

Stock Options: is the right to purchase a unit of the organization's stock at specified price, called the option price

- Often used to reward senior executives and employees