MANAGEMENT INFORMATION AND EXTERNAL REPORTING – Six case studies

J Innes and J Moyes
MANAGEMENT INFORMATION AND EXTERNAL REPORTING
- SIX CASE STUDIES

by

J Innes and J Moyes
University of Edinburgh

Published by
THE INSTITUTE OF CHARtered ACCOUNTANTS
OF SCOTLAND
27 QUEEN STREET, EDINBURGH EH2 1LA
This book is published for the Research Committee of The Institute of Chartered Accountants of Scotland and does not necessarily represent the views either of the Research Committee or of the Council of the Institute.

No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the author or publisher.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publisher.
FOREWORD

The publication in 1988 of "Making Corporate Reports Valuable" (MCRV) was the result of a major research project undertaken by the Research Committee of The Institute of Chartered Accountants of Scotland and funded by the Scottish Chartered Accountants' Trust for Education. MCRV was intended to stimulate debate and encourage action on ways of improving corporate reporting.

Specifically we hope to encourage improved communication between management and investors. We believe that the long-term objectives of investors are similar in principle to the strategic objectives of management but the present differences in the quality of information available contribute to the perceived communications gap between the two groups. This first stage of a two-part research project undertaken by John Innes and Jim Moyes considers the financial and non-financial performance measures used by management and the information held by them on the company's economic environment. The second phase of the research will determine the usefulness, in an external reporting context, of publishing such performance and market information.

The results of the first phase show us that, as we suspected, the information used by companies for decision-making differs significantly from that which is reported to shareholders under legislative and professional requirements. We are encouraged by the results of the case studies which demonstrate that it would certainly be possible to make additional disclosures in annual reports of information (already available in companies) relating, for instance, to measurements of performance in non-financial terms.

It is our hope that, in reading this book, company management will be stimulated to begin to remove the unhelpful division between internal and external reporting which exists at present.

The Institute of Chartered Accountants of Scotland

JACK SHAW
Convener, Research Committee
CONTENTS

Acknowledgements

Executive Summary 1

Chapter 1  INTRODUCTION 3
- Research Objectives
- Internal and External Reporting
- Objectives of Financial Statements
- Sophisticated Investors
- Internal Forecasts
- Economic Environment
- Developments in Management Accounting
- Summary

Chapter 2  FINDINGS 19

Chapter 3  CONCLUSIONS 27

Case Studies  COMPANY A 30
- Objectives
- Performance Measures - Financial
- Performance Measures - Non Financial
- Economic Environment and Future Internal developments

COMPANY B 47
- Objectives
- Performance Measures - Financial
- Performance Measures - Non Financial
- Economic Environment
ACKNOWLEDGEMENTS

We wish to thank the many accountants and managers who gave generously of their time and knowledge in helping us to prepare the six case studies contained in this report. We are also grateful to Jim Bishop of Ernst & Young who assisted us in some of the interviews. Our sincere thanks are also due to The Institute of Chartered Accountants of Scotland for funding our research and to its Research Committee and a reviewer for their helpful comments on this report.
EXECUTIVE SUMMARY

This research project originated from the publication of The Institute of Chartered Accountants of Scotland entitled "Making Corporate Reports Valuable" (1988). The main part of this research project consists of six case studies covering a range of companies and emphasising:

1. the objectives
2. the performance measures (both financial and non financial)
3. the future - orientated material
4. the information about the economic environment (market, competitors and general economic environment)

which managers use in running these companies. "Making Corporate Reports Valuable" (1988) suggested that such information could also be made available to external users via a company's Annual Report.

All the companies produced a general statement of objectives and in general no major problems were foreseen in publishing such objectives in their Annual Reports. Similarly all the companies had developed a range of non-financial performance measures to complement their existing financial measures. These non-financial measures were mainly internal (for example quality measures) but also included market based non-financial information (for example brand awareness, brand standing and customer preferences). Once again most managers considered that some of the non-financial performance measures could be disclosed in the Annual Report. The managers in all the companies used forecasts and budgets extensively but they expressed a general reluctance to disclose such information in the Annual Report. A similar reluctance was expressed about the disclosure of information on the economic environment.
Many interviewees stressed the problem of short-termism and suggested that the disclosure of additional types of information might be one way to try to reduce this problem and to encourage more emphasis on the long-term performance of companies. There is considerable pressure for additional disclosure of "decision useful" information in external financial reporting.

This research report details possible types of additional disclosure of information already available within companies. Further research is required to determine whether or not external users consider such additional disclosure to be useful and worth the extra costs involved.
CHAPTER 1 - INTRODUCTION

This chapter discusses the objectives of the research project, the relationship between internal and external reporting, the objectives of financial statements, sophisticated investors and financial statements, external reporting of internal forecasts, external reporting of the economic environment and recent developments in management accounting (including non-financial reporting). It should be emphasised at the very beginning that more general literature reviews of some of the above topics can be found in "The Literature Surveys for Making Corporate Reports Valuable" (1988) but we have attempted to highlight and expand the relevant points from the literature relating to this specific research project.

Research Objectives

The research project originated from the publication by The Institute of Chartered Accountants of Scotland entitled "Making Corporate Reports Valuable" (1988). This discussion publication (paragraph 5.41) argued that "management should have before them information about important aspects of the economic environment within which the entity operates, and we can see no reason why it cannot also be made available to investors". Indeed, in a review essay Mumford (1989, p385) has suggested that this discussion publication:

"is based upon two clearly stated precepts (pp.18-20), that all financial reports ought to reflect economic reality, and that the information which investors need is the same in kind, but not in volume, as the information which managements need to run the entity. Both precepts are controversial and lack substantiation".

Following the publication of "Making Corporate Reports Valuable", The Institute of Chartered Accountants of Scotland supported a number of research projects including Tom Lee’s examination of economic reality, the field testing by Pauline Weetman (1990) of a
new set of core financial statements using the net realisable value concept and this project into the external reporting of performance measures and aspects of the economic environment used by top management.

In addition to the above theme, this research project also included a second theme originating from "Making Corporate Reports Valuable". This second theme related to the future financial position and performance of companies. In paragraph 5.38 of "Making Corporate Reports Valuable", the Committee argued that "the future-orientated material which managements employ in planning the business should, up to a point, be available to the shareholders as well". The objective therefore of the first stage of this research project was to determine, by drawing on information supplied by six companies spread over both the manufacturing and service sectors, the type of financial and non-financial performance measures (both past and future-orientated) which are used in practice and the type of information on the market place and on competitors which management have. In the future, the second stage will be to determine the usefulness in an external reporting context of publishing such performance and market information.

Internal and External Reporting

In "Making Corporate Reports Valuable" the Committee made explicit their belief in the relationship between internal and external reporting by stating in paragraph 3.2 that "we have reason to believe that nearly all well-run entities have internal reporting systems which will include various of the suggestions that we put forward later in this discussion document". The significance of this link between internal management information and external financial information is emphasised by Chambers (1989) in his appraisal of "Making Corporate Reports Valuable". Chambers (1989, p26) argued
INTRODUCTION

that "by contrast with other inquiries and reports, the ICAS Research Committee that produced this discussion document chose to 'break new ground', to consider BOTH external and internal uses and users of accounting information".

Given the fact that for any company the same economic events, activities and transactions underlie both financial and management accounting reports, it is perhaps surprising that external and internal uses and users of accounting information should have grown so far apart. For example, Allen (1989, p21) has suggested that for many companies the rate of change in the business environment means that the information demands from managers cannot be met by a management accounting system which is constrained by the requirements of external financial reporting. Allen points out that in many companies, therefore, the internal management accounting and the external financial accounting systems have been completely separated so that management accountants can provide relevant information to managers. This raises the question of how relevant are financial accounts? Can the information needs of external decision makers in a rapidly changing environment be accommodated within the constraints imposed by financial accounting concepts?

When considering this topic of the external reporting of internal management information, it is helpful to remember the historical context. The published financial statements of companies are now very closely regulated but at the start of this century such published financial statements were almost free from any regulation. Given this lack of regulation at the beginning of the twentieth century Edwards (1989, p142) argued that it was not surprising that companies disclosed additional information to that which was the legally required minimum.
INTRODUCTION

However this was voluntary extra disclosure by the companies concerned, and, just as today when the call for additional types of disclosure can raise cries of complaint, in the 1920s Robbins (1929, p65) could comment that "every corporation should be compelled by law to publish complete detailed reports of its internal affairs. This shocking proposal is receiving considerable attention in the United States today". In his literature review for "Making Corporate Reports Valuable", Lee (1988 p200) argued that the information for senior management could be reasonably similar to that for shareholders although he also emphasised that most authors ignored this issue. Of those authors who have commented, Arnold, Carsberg and Scapens (1980) and Fraser and Nobes (1985) argued that internal and external report users have different needs; whereas Sterling (1985) proposed the opposite case and Lee (1988, p202) concluded that "there is little to suggest in the literature that, at least at the level of senior management, the information needs of management (as distinct from managers) are substantially different from those of the major external groupings."

Objectives of Financial Statements

In The Literature Surveys for "Making Corporate Reports Valuable", Weetman and Gordon (1988) covered the objectives of financial statements in some detail starting with Moonitz (1961) and including others such as AAA (1966), AICPA (1973), ASSC (1975), Department of Trade (1977), FASB (1978), Macve (1981) and Solomons (1989). The Corporate Report (1975, p28) stated that the fundamental objective of corporate financial reports was "to communicate economic measurements of and information about resources and performance of the reporting entity useful to those having reasonable rights to such information". By 1989 the function of financial reporting had changed little with Solomons (1989) arguing that it is to provide information to assist users in:
INTRODUCTION

1. assessing the financial performance and the position of the enterprise;

2. assessing the performance of those responsible for its management;

3. making decisions about users investing in, lending or extending credit to, doing business with, or being employed by the enterprise.

In a comparison of Solomons (1989) and "Making Corporate Reports Valuable" (1988), Whittington (1990) emphasised the similarities between the proposals of these two reports.

Most of the above reviews of the objectives of financial statements tended to concentrate on various groups of external users of financial statements (whose uses of financial statements will be considered in the next section) and to neglect the requirements of political decision-makers. However, it can be argued that the above objectives of financial statements with their concentration on the needs of shareholders, investment analysts and creditors have been one of the factors encouraging the short-term approach within corporate management. For example, Bromwich and Bhimani (1989, p43) argued:

"One important difference between the West and Japan is the relationship between business and the state. For instance, it is well known that in considering corporate investment, the Japanese favour the long-term pursuit of growth as opposed to short-term profitability .... Firms are encouraged to plan their long-term investment relatively free from concerns about reactions from players external to the firm ...."
"Making Corporate Reports Valuable" was also concerned with this problem of short-termism. Lee (1988, p12) has suggested three main objectives of corporate financial reporting perceived in this discussion document:

1. Reported information is seen as assisting in the overall task of corporate governance - of allowing companies and their managers to be seen to be discharging specific and statement responsibilities ....

2. The need to allow various interested individuals and organisations to judge the performance of corporate management ....

3. The need to provide decision makers of all types with better access to information related to their decisions ...."

The question of the objectives of financial statements has still not been fully answered and therefore Lee's above interpretation will be used as the basis for this research project.

Sophisticated Investors

In The Literature Surveys for "Making Corporate Reports Valuable", Weetman and Gordon (1988) covered empirical research into the needs of users of financial statements including 20 studies in various countries. The main conclusion of Weetman and Gordon (1988, p51) from their review of the literature was that "the fragmentary nature of the research and the haphazard selection of topics make it difficult to produce a coherent summary". This research project concentrates on the 'sophisticated' users of accounting information such as investment analysts and institutional investors although McCaslin and Stanga (1986) found in their study that the information needs of financial analysts were similar to those of bankers making loan decisions.
INTRODUCTION

Some of the findings of the research on the information needs of 'sophisticated investors' are contradictory. For example, Anderson (1981, p264) found that "only eight institutional investors desired a forecast of future sales and profits, which suggests that they would prefer to make their own estimates of future earnings per share". In contrast McNally, Eng and Hasseldine (1982, p14) asked stockbrokers and financial editors to rank in order of importance 41 items of disclosure and the top two were:

1. statement of future dividends/dividend policies;

2. profit forecast for next year.

In her study of financial analysts, Day (1986, p302) had a similar finding to that of McNally et al with all the analysts examining the Annual Report for hints as to future prospects. One other finding from the sophisticated investors' research which is particularly relevant to this research project is that of Anderson (1981, p264) who in his survey of institutional investors found that the most common request for additional information was in relation to company operations namely "information about company products, including major brand names, whether the company was improving its share of the market, and the quality of the products". Although there have been a few further studies of sophisticated investors since 1985 the conclusion of Parker is still relevant today. Parker (1985, p18) concluded that "while the role of professional investment analysts appears to have been widely recognised, their financial information needs have not always received the attention they deserve".
INTRODUCTION

Internal Forecasts

It has long been recognised that users such as financial analysts find financial statements helpful as one input in their own forecasting process for the future results of that particular company. One basic objective of financial statements discussed above is to give users information related to their decisions, and decision-making generally involves some kind of assessment of the future. Indeed the AICPA (1973, p165) stated explicitly that "an objective of financial statements is to provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability of users' predictions". The suggestion that companies should report to external users a summary of their financial forecasts has been made by several of the authors over a number of years. To give a selection of examples, Burton (1969, p9) reported that several financial analysts requested that companies should disclose their future plans. Bedford (1973, p200) predicted that "disclosure of management plans and expectations on an annual and possibly on a five-year basis may be anticipated, as the present trend of full disclosure gains strength". The SEC surveys (1977, p14) in the United States found that shareholders wanted information about the future including a company's profit forecast and also a forecast about each industry's future prospects.

It is not only individual authors and findings of surveys but also professional accounting bodies such as the AICPA (1973) which have supported the disclosure of financial forecasts. Another example is The Canadian Institute of Chartered Accountants (1980, p98) which suggested that "another area where additional disclosure is worth considering is the provision of numerical financial forecasts by management, in supplementary statements to be included in the Annual Report". Further support for the disclosure of companies' financial forecasts continued throughout the 1980s. For example, arguing from the viewpoint of sophisticated investors, Drury (1982,
INTRODUCTION

predicted that "although not in the immediate future, the eventual publication of financial forecasts seems to be a reality". Using the basic idea underlying principal-agency theory, Penro (1985, p20) argued that financial statements are a means of communication between managers and the shareholders and this should include managers giving shareholders their forecast of future profits.

Parker (1985, p34) summarised a number of authors:

"Suggestions regarding the provision of forward-looking information included capital expenditure plans, new product introduction, general summary financial forecasts, expected growth in company earnings per share, economic outlook of the company and its industry, new markets and goals (Business Week, 1976, p73; Dickinson, 1976, p432; Sellers and Milam, 1976, p21; Groves, 1980, p16; Hines, 1981, p48)."

Parker's summary emphasises that when discussing the reporting of forecasts, such forecasts should be viewed in a wide sense to include not only internal management's earnings or cash flow forecasts but also their forecast or statement of that company's objectives. At this stage it is perhaps appropriate to remember the findings of Tippett (1988) in his survey of 19 companies related to "Making Corporate Reports Valuable". Tippett (1988, pp13 and 14) found that 16 of the 19 companies were in favour of a statement of corporate objectives being included in external financial reports. However, only 7 of the 19 companies were in favour of including a narrative summary of the company's financial plans in the published financial statements. Furthermore, all 19 companies were unanimously against the proposal of including forecast cash flows in the external financial reports.
INTRODUCTION

Of course, it could be argued that the value of these three items of information to the external user (namely statement of corporate objectives, financial plans and forecast cash flows) may vary inversely with the willingness of internal management to disclose the information. In other words, external users may wish budgeted cash flow data to be disclosed in the annual report. Indeed, "Making Corporate Reports Valuable" (1988, p107) concluded that "we regarded Cash Flow Statements, both current and forward, as essential for directors; they should also be provided in modified form to external users". However, a number of authors over the years have attacked the suggestion that companies should disclose a summary of their internal forecasts. Walker, for example, (1988, p172), in a literature review related to "Making Corporate Reports Valuable", argued that "traditionally, and in the current author's view wisely, the regular reporting of forward looking financial forecasts in corporate reports has been discouraged". Instead, Walker makes the 'quiz show' suggestion that a company could lodge its annual budget in a sealed envelope with its auditors at the beginning of its financial year, and at the end of that financial year that budget together with the actual results of that company would be disclosed to external users.

Walker's 'quiz show' suggestion would be one way to overcome Chamber's antipathy to the disclosure of forecasts in annual reports. In his review of "Making Corporate Reports Valuable", Chambers (1989, p.28) suggested that the publication of detailed financial forecasts would be detrimental to entrepreneurial companies which wished to exploit new products and processes. However, despite the fears of Walker (1988) and Chambers (1989), 'Making Corporate Reports Valuable' (1988, p.101) argued that external users of financial reports wish to know about the future prospects of a company and, therefore, managers should disclose in their annual reports some of the data about the future which managers already use when taking decisions.
INTRODUCTION

Economic Environment

The internal forecasts discussed in the previous section can be placed not only in the context of a statement of that company's objectives but also in the context of the company's economic environment by giving information about the industry and competitors. Indeed, 'Making Corporate Reports Valuable' (1988, p.99) suggested that one of the 'fundamental information needs of external users is the present and projected environment of the entity' which included facts about the market and comparative operational statistics.

Parker (1985, p.65) has reminded us that such information on the economic environment can be very closely related to the external reporting of internal forecasts including such items as:

1. Capital expenditure plans
2. Introduction of new products
3. Projected growth in sales and income
4. Economic outlook for the company and its industry.

In relation to this recommendation about reporting on a company's economic environment in its annual report, Lee (1988, p.18) commented that "the need to report on the influence of the economic environment on the reporting company is a considerable breakaway from conventional reporting but it reflects the corresponding changes in the internal management reporting function".

Just as with the external reporting of internal forecasts, so the reporting of information on a company's environment emphasises the link between management and financial accounting. For
INTRODUCTION

e.g., Tippett (1988, p.10) in his interview survey of 19 companies found that approximately half of the companies included a survey of markets and competitive conditions in their monthly financial report. In addition, Tippett also found that only a few companies included a comparative analysis of their competitors' performance relative to their own performance in the monthly report to the Board of Directors. In other words, the external reporting of some economic information might force some companies to reconsider their own collection of such data. Current developments in management accounting are therefore very relevant for this research project into external reporting.

Developments in Management Accounting

Again, this area is well covered in the review by Lee (1988) for "Making Corporate Reports Valuable". Lee (1988) emphasised the need for cash flow data, the requirement to monitor the environment, the importance of feed-forward control implying the significance of forecasts, the need for strategic information and the importance of non-financial measures. The topics of the environment and forecasts have already been discussed and this section will concentrate on two areas of relatively recent development in management accounting namely strategic management accounting and non-financial information.

Since the publication of "Making Corporate Reports Valuable", a report by Bromwich and Bhimani (1989) entitled "Management Accounting: Evolution not Revolution" has been published. Indeed one of the problems highlighted by Bromwich and Bhimani (1989, p2) is "the alleged subservience of management accounting to external financial accounting requirements". The relationship between internal and external reporting can work both ways. Recently, strategic management accounting has received a great deal
of attention (see for example IFAC (1988)), although Simmonds (1981) highlighted the importance of this area in the late 1970s. Based on the empirical results from Coates and Longden (1989), Innes and Mitchell (1989) and Littler and Sweeting (1989), Bromwich and Bhimani (1989, pp.5-6) concluded that "management accountants need to adopt a more outward-looking and strategic perspective both for investment justifications and for broader decision-making". For example, Innes and Mitchell (1989, p.28) found that some management accountants were adopting a more outward looking perspective using techniques such as competitive analysis, design for cost and landed cost.

A summarised version of some of the output from such strategic management accounting might be very relevant for external users. At one level in his survey of 19 companies for "Making Corporate Reports Valuable", Tippett (1988, p7) found that all but three companies had a formal system of strategic planning and two of these three used a qualitative plan for the company's future. At another level Bromwich and Bhimani (1989, pp.41-2) suggested that "an important lesson for Western companies is the close relationship between corporate strategy and the organisational policies, systems and processes evident in Japanese firms... Western firms are only now beginning to appreciate the value of non-financial quantitative and qualitative data". As Bromwich and Bhimani have pointed out, management accountants are paying increasing attention to non-financial information, but this internal change in emphasis has not yet been reflected in external reporting terms.

INTRODUCTION

that "both the Japanese and the American companies are using entirely non-financial measures to monitor and control their production". These non-financial measures included quality, manufacturing lead-times, labour productivity, vendor lead-time and absenteeism. Bromwich and Bhimani (1989, p.94) have argued that "management accountants can therefore no longer ignore information that is not expressible in financial terms". If management accountants cannot afford to ignore such information, should financial accountants not be reporting at least a summary of some of this non-financial information in the annual report?

Nevertheless, the state of development of non-financial performance measures must be kept in perspective. For example, Jeans and Morrow (1990, p.51) found that "formal measurements for relative customer service are rare (despite this being the most frequently mentioned factor in describing competitive position)". In his guide to non-financial indicators Lothian (1987) emphasised that most of the managers interviewed still depended heavily on the financial measures produced by the accountants. Nevertheless, Lothian encouraged accountants to experiment with non-financial performance measures while at the same time warning that the significance of individual non-financial measures will change over time.

Another related issue raised by Bromwich and Bhimani (1988, p.7) also has implications for external financial reporting. This is the place of non-financial information in the relationships between companies and sub-contractors where the question is raised of what is the entity. In some instances the sub-contractors seem to be in the same position as subsidiaries in terms of the economic and commercial reality of the situation even although the sub-contracting companies are separate legal entities. The entity question is also relevant for external reporting with, for example, some Japanese companies exerting control over sub-contractors not by financial or
INTRODUCTION

even voting control but by seconding employees including accountants to work in the sub-contracting firms.

So what are the implications of these developments for this research project into external financial reporting? Parker (1985, pp.67) suggested the need for a highlights statement in the annual report including both financial and related operational data. Such a statement would contain both financial and non-financial comparative and explanatory information. Similarly from his analysis of the literature reviews for "Making Corporate Reports Valuable" Lee (1988, p.14) concluded that "there is a need for both financial and non-financial information in the reporting package in order to portray economic reality".

Summary

This literature review has covered a number of areas but perhaps the main point to emerge is the importance of exploring the significance of this link between internal and external reporting. This has been a neglected area of research and this project will explore specifically the information available within six different companies on the following areas:

1. financial and non-financial performance measures;

2. the company's economic environment and in particular information on the economic outlook for the industry, on markets in general and on competitors in particular.

The objectives of financial statements and the information needs of so-called "sophisticated investors" imply the importance of companies reporting externally:
INTRODUCTION

1. a statement of corporate objectives;

2. a summary of forecasts available to management.

These four areas of corporate objectives, forecasts, performance measures (particularly non-financial) and economic environment are the four main themes running throughout the six case studies. In these six cases the topic of forecasts is sometimes mentioned under the objectives heading but is discussed mainly under the topic of performance measures.
CHAPTER 2 - FINDINGS

The Research Committee of The Institute of Chartered Accountants of Scotland helped to define the criteria for selecting the six case studies with the basic objective of achieving some diversity in the following background factors:

1. company size;
2. private and public companies;
3. local companies, British multinationals and foreign subsidiaries;
4. manufacturing and service sector companies.

The final six companies which agreed to cooperate in this research project included:

1. companies having from 1,000 to 30,000 employees;
2. two private and four public companies;
3. three with only British operations, two British multinationals and one subsidiary of an overseas multinational;
4. three manufacturing companies, one operating in both the manufacturing and service sectors and two service sector companies.

The case material was gathered by visiting the companies, interviewing certain members of staff and obtaining copies of relevant management information reports. Interviews for five of the six companies included interviews at the head office of the group with the interviews for the remaining company (a foreign multinational) being conducted at the head office of the British subsidiary. The number of interviewees ranged from two for the
smaller company (the Managing Director and the Finance Director) to twenty, with the total interview time with the Finance Director and accounting staff taking from several hours to several days in total and the interviews with the managers lasting on average one and a half hours each. Before each interview the interviewee was given a sheet explaining the background, objective and mechanics of this research project (see Appendix 1). Two researchers were present at all the interviews. A semi-structured interview approach was used and the checklist of questions and topics for the interviews with the Finance Director is given in Appendix 2 and that for the Managers is in Appendix 3. Each case write-up was reviewed by the relevant company to remove any inaccuracies or misunderstandings. The six case studies for companies A to F are given in detail after the chapter entitled Conclusions.

All the companies use their monthly management accounts as one source of the financial information which they provide for management. The internal accounts are linked to and at least partly driven by the requirements of the external financial reporting systems, which are in turn subject to the requirements of the Companies Acts, the Stock Exchange and Statements of Standard Accounting Practice. Certain modifications to the basic historical cost model for financial statements were evident. Company B for example produced an operating report which introduced modifications in order to show the effect of inflation, stock revaluation and interest on working capital. The other companies tended to be less adventurous in this area, however. Perhaps the development of non-financial performance measures is a means by which performance can be reported without compromising the "accuracy" of the financial picture presented by the annual accounts.

There was a general feeling conveyed by companies which were exposed to the financial markets (particularly Companies A, C and E) that long term performance was being prejudiced by the
FINDINGS

pressure to produce short term results. Three companies had financial structures which in some measure protected them from this pressure, and of those, two were set on maintaining this situation. Of the companies whose shares are actively traded through the stock exchange, two have had to redeploy considerable resources in recent years to deal with financial rather than operational matters, thus resulting in a greater emphasis on public relations, and in a more assiduous courting of the investment community. The choice of primary objective tended to be associated with the financing relationships with Companies C and D giving prominence to growth in earnings per share, while Company F pursued profit in absolute terms. By contrast, Company B seems to have more of a satisfying approach to the setting of corporate objectives, blending financial and non-financial objectives into a multi faceted "mission statement."

All of the companies use their financial data in order to produce a number of conventional ratios and relationships similar to those which can be produced from a set of external accounts. In particular, return on capital employed, return on sales, earnings per share, cost ratios and stock turnover figures were reported routinely although undoubtedly one reason for reporting these ratios was that external parties (such as investment analysts) assess companies in terms of such ratios. Although not accorded the prominence that profit related information receives in the public perception, cash flow information is seen by the companies as being comparable with profit related information in importance. Company A seemed less concerned about cash management than the others, but its situation is rather unique in that it does not have marketing responsibility for its products.

A significant development which has affected all the companies has been the development of a range of non-financial performance indicators, perhaps most strongly developed in Company A, with its "tiered" quality improvement information. Such non-financial
FINDINGS

information can play a critical role in the actual management of the business. Company F has begun to expand its information system to embrace external market based information much of which is non financial; while Company C is developing brand based information and is using non financial information to indicate brand awareness, brand standing and customer preferences. Non-financial information is rarely used in isolation but what seems to be happening is that it is used in conjunction with financial information so that a more reliable perspective on a variable can be obtained. Quality information, for example, can be expressed in terms of the cost of quality, the cost of non quality, the percentage of input which is wasted, the number of defective products, the time spent on rework, the consequences in terms of opportunity cost or by means of a composite measure such as is used by Companies A and E. Quality as a desirable component of the product or service produced was stressed particularly by the manufacturing companies as evidenced by companies A and E which have developed significant quality reports. Further developments can be expected in this area particularly as companies in the service sector develop a methodology for indicating the quality of their service provision. It seems reasonable to suggest that external readers of companies’ Annual Reports should be given at least a summary report on such non financial performance measures.

All the companies had a general statement of objectives and saw no major problems in publishing such objectives in their Annual Report. In contrast, although all six companies went to considerable lengths to produce budgets not one company was enthusiastic about disclosing details from the budget to readers of the Annual Report. Without budget disclosure, variances from budget could not be disclosed either. The companies all produced detailed budgets, with budgeting procedures becoming more formalised as the size of the company increased. For the larger companies, a "top down bottom up" budgeting system tended to operate, with head office or group
setting the initial targets, which were thereafter operationalised or amended after consultation with the managers of sub units. There was a considerable variability in the format of the budget/actual comparison statements which were produced, the trend being away from a single comparison and towards using a range of factors which may include budget and prior period (Companies C and F), budget and forecast (Company E) or a range of revised budget figures (Company A). Although "historical cost" is the accepted format for reporting externally, Company B deflates the figures in its management accounts in recognition of the prevailing inflationary environment within which it operates. Both Companies A and B isolate the effect of exchange rate movements from operational factors in their management accounts.

The objections to budget disclosure were based on two arguments, firstly an external one that it would prejudice the need for confidentiality and would provide useful information to competitors, and secondly, an internal argument that such disclosure would modify behaviour, putting further external pressure on the company to perform to the budget. This would lead to operational changes such as an increase in budgetary slack, which would not be beneficial in the long run. One respondent argued that such disclosure would affect how companies are managed, because they would be influenced by their ability to be judged against competitors in terms of budget achievement, rather than on a stand alone basis. Interestingly, from one of the companies, the view was put forward that external budget disclosure would cause no additional managerial pressure, since the company was already a management by objectives organisation, and the "pain" which failure to achieve objectives already generates could not be further increased. Building slack into external forecasts while developing internal budgets on an "objective" basis was thought to be a possible reaction to a requirement for additional external disclosure, but this strategy becomes transparent in the long run, due to the bias which it introduces.
FINDINGS

This research project has concentrated on the views of preparers of management information and also of managers and the next stage of this research will be to ask readers of the Annual Reports (such as investment analysts) whether or not the disclosure of forecast information in the Annual Report would be useful. Undoubtedly the information is available within companies at present. One former Finance Director of a very large public company Allen (1990, p.37) concluded in his recent study of the financial management of brands:

'The message that a misunderstanding of financial accounting numbers is a cause of short-termism is clearly of major significance. Management accountants are particularly well-placed to advocate a forward-looking approach which gives appropriate weight to the longer term .... If so, it would be possible to argue that the annual general meeting of public companies should include some forward-looking components.'

Although almost all the interviewees in the six companies did not favour including forecast information in the Annual Report, some interviewees thought that in the near future disclosure of such forecasts would become mandatory.

As regards the economic environment, competitive analysis is undertaken by all the companies with the resources devoted to this area being related to the size of the company. Companies A, B, C and F in particular paid a great deal of attention to the products and activities of competitors. Company C, whose products are well known, has started to value its brands, and to measure success partly in terms of an increase in brand values relative to its competitors. All the companies monitor the environments within which they operate, this monitoring being particularly pronounced in the service companies, D and F which monitor items such as demographic
trends, the level of regional employment, regional earnings and consumer spending levels. Perhaps since there is no tangible product to assess and to provide a focus for comparisons, success becomes more dependent upon the ability to react to, and, more critically, to predict and anticipate movements in the overall environment. All the companies expressed a desire for more information about their environments, this being a natural consequence of operating in a market economy, but the requirement for more regional information (C, D and F) should be capable of being met, as should the issue of the timeliness of the issue of government statistics. The fact that the structure of the economy is shifting towards being service oriented, may therefore reinforce the need for better economic and social statistics. The amount and also the quality of information on the general economic environment, the specific markets and the competitors of the six companies varied greatly between the companies and once again most interviewees were reluctant to consider additional disclosure in these areas in the published Annual Report. Towards the end of each interview, the interviewees were asked for their reaction to the suggestion that since there seemed in general to be a divergence between the information which was used by internal management and that which was made public, might there not be merit in increasing the extent of the external disclosure by including some of the information which internal management find useful. The reaction to this suggestion varied considerably, from a clear statement that there was enough disclosure at present, and that investors are very well informed at the moment, to a qualified acceptance of the need for additional disclosure, particularly since "much of the information would be so summarised as to present no threat."

In the long run, it was expected that additional disclosure would be a requirement. Indeed, there seemed to be a general feeling that the principle that all shareholders should be treated similarly was being breached by the amount of disclosure which was already made
FINDINGS

available in presentations to analysts and institutional investors, but not to the individual shareholder. One of the respondents from the financial services company felt that even in his area there was an increasing spirit of openness with the analysts, and that information would be provided without being specifically requested - a major change from the prevailing ethos of even a few years ago.

The items which interviewees thought to present possibilities as regards additional disclosure in the short-term were:

1. a general statement of objectives;

2. more segmental information, particularly in respect of non financial information;

3. non financial performance measures to complement the existing financial measures.

Finally, there was a strong overall impression given that companies see external disclosure as a facet of public relations, with the physical "packaging" of the annual accounts being of considerable importance, and even private companies producing a high quality, expensively produced Annual Report. As a manager from one company suggested, "a major consideration is now what the outside world thinks of the company". In the current environment it would seem that companies are, at the margin, disclosing more than they are required to, and that this additional disclosure probably gives them some advantages rather than disadvantaging them. There is merit in determining what additional disclosure progressive companies are in fact making, both in the UK and elsewhere, and in ensuring that best practice is reflected in the required disclosure to shareholders.
CHAPTER 3 - CONCLUSIONS

The three main items which interviewees suggested as presenting opportunities as regards additional disclosure were:

1. a statement of objectives;

2. more segmental information;

3. more non-financial performance measures.

Many of the changes which are taking place in the ways in which companies gather, prioritise and use information are viewed by some managers as being primarily of internal relevance. Some managers are worried that additional disclosure of information may in some way jeopardise competitive advantage or may adversely affect the decisions of managers in the reporting company. Thus additional disclosure must be viewed in the context of an environment in which different companies collect and use different types of information for their internal decision-making purposes.

Viewed in this context, the recent 1990 publications from CIMA (Corporate Reporting, The Management Interface) and the Auditing Practices Committee (Exposure Draft, Auditing Guideline, Prospective Financial Information) both contain suggestions which might have a role to play in assisting managements to specify an appropriate information set, as much as influencing disclosure. As the APC Guideline (1990, p 20) states, "an important factor in determining the reliability of prospective financial information is the quality of the management information system from which it has been prepared." The CIMA publication takes the view that the effect of increased disclosure on corporate health will come through four stages:

1. increased disclosure will improve shareholder understanding and hence increase shareholder loyalty;
CONCLUSION

2. increased shareholder loyalty will provide a better environment for management decision making;

3. a better decision making environment will lead to better decisions;

4. improved performance will result from (3) above, which will increase willingness and confidence to disclose.

From the previous chapter which analyses the information from the company studies, and from the studies themselves, it can be seen that the information which is used by companies differs in significant measure from the information which is reported to shareholders. Since companies routinely accumulate management information, the disclosure of some of this information to a level which would give maximum advantage to external users—while not disadvantaging the disclosing company either commercially or in terms of imposing unacceptable costs of collection—should be a priority. The weakness of the present retrospective historical cost based reporting system is highlighted at the present time, as the corporate sector enters a period of recession.

In addition to the above three items suggested by the interviewees as possible additional items to disclose in the Annual Report, extra information which might be disclosed in the Annual Report in the longer term includes:

1. an assessment of the economic environment and of future prospects;

2. market share information;

3. general information about competitors;
CONCLUSION

4. employee information;

5. forecasts (in cash flow or profit terms or both) and the reasons for the variances between actual and forecast results.

Much of this information is already available within the six companies studied. Some is already being disclosed within the Chairman's report or as additional statistics given as part of the Annual Report. If corporate reporting is to be put in a framework which will allow an outsider to gain an understanding of the overall performance of each reporting entity, it may be necessary to break away from the straightjacket imposed by historical cost accounts. Much of the relevant information for the Annual Report may have to come from hitherto unexploited non-financial areas and from forward projections - two critical components of the internal management information which accountants are producing and which managers are using at present within companies.
CASE STUDY – COMPANY A

Company A is a manufacturer of a range of electro-mechanical products which can be modified to meet particular customer requirements. The products are sold to a world market, which is roughly divided into two different sectors due to differences in the typical customer profile as between the USA and the rest of the Western Economies. No single product would be appropriate to the needs of both sectors, due to differences in the required capacities of the products supplied to the different markets. The market valuation of the products also differs as between the two market sectors, with the American market generally characterised by lower prices for similar products than those typical elsewhere – even though the products in question may be actually produced in Europe. The products themselves have something like a five year life expectation, over which period they must be supported by a servicing function. Company A is part of a Multinational Corporation, focused on complementary areas of activity. Company A performs two functions; a production function and a design function, employing similar numbers of staff in each. The Company employs a large number of skilled personnel due to the technical difficulty associated with production and to the qualities required by product design. The Company reports to head office monthly, and views this internal information as being more significant than the production of legally required financial information for the purposes of external reporting. The Company as it stands is of recent origin, although its roots go back for a number of years. At present, it is the largest employer in its immediate area.

Objectives

A number of personnel were spoken to in this Company, the overall objectives outlined therefore being a fusion of the various opinions expressed. Formal objectives are set by head office, and a management by objectives process exists whereby the Company is judged against a financial annual plan which embraces items such as:
CASE STUDY - COMPANY A

(i) revenue targets
(ii) inventory targets
(iii) plant expense targets.

These targets are reviewed quarterly to take account of changing conditions, and monthly budgets are also drawn up within each quarter. Each quarter a new demand forecast for the next 18 months is also agreed with head office.

The operational objectives on which management focuses include a wider range of objectives than those outlined above, however, with the following being particularly significant. Product quality is seen as being of paramount importance. In this business, where products have a relatively long life cycle, there is currently a concern over the level of product change which is experienced. Product change is introduced for reasons such as cost reduction or improvement in marketability, but there is a recognition that the level of product change is inversely proportional to the quality of the original design. A costing exercise has been carried out to determine the administrative costs associated with each product change, which are substantial. Some 20% of product change decisions are prompted by feedback from the field (such as reliability and marketing) the remainder being from internal cost reduction and manufacturing decisions. It is seen as particularly important that engineering change is managed so that it is correct first time, such change being reviewed in detail before release. Any technical errors which are not identified before they have resource implications can have extremely expensive consequences, such as through the purchase of useless tooling, which has subsequently to be scrapped.

Performance objectives are closely connected with achieving quality objectives in the areas of design, manufacture and follow up service. Of those, the quality of the design release is the most critical. A quality group has been set up, and meets weekly to discuss all
CASE STUDY - COMPANY A

matters associated with product quality, and internal assurance sample check drawings and designs for both technical and clerical error, of which the former has the greatest potential for damage. Internally, quality improvement targets are set. It was felt that in areas such as quality, a financial evaluation of all of the consequences of an improvement might not be possible, for while an evaluation of changes in costs or in levels of WIP can be made, it is not possible to evaluate the overall effect of the change since it may have an influence upon variables such as flexibility or customer perceptions, which do not lend themselves to easy quantification. The Company is moving towards Just In Time (JIT) based production, and a pilot JIT scheme has been introduced. JIT production promotes the belief that non-financial factors such as process quality and cycle time need to be constantly looked at. This leads on to the search for "trigger mechanisms" - the factors which cause results and to the measurement of costs at the point at which they are created rather than an ex post evaluation of the cost consequences of previous action. Such an emphasis may result in a greater focus on people, as trigger points, within the organisation.

JIT was also felt to be a driving force in changing performance measures, to the extent that it stimulates a questioning as to whether the right factors are being measured. Success depends upon an awareness of the significant inter-dependencies within business functions - for example the materials manager is assessed on the amount of inventory in the plant, but the production manager influences inventory by decisions which influence lead times. JIT emphasises these inter-dependencies by focusing on questions such as, "how many times has the line stopped because of inventory shortage?"
CASE STUDY - COMPANY A

Performance measures - financial

The key performance report is the monthly management report which is sent to head office, containing information on items such as revenue, plant expense, inventory, cash flow and research and development spend. Variances are itemised and explained. There is also a statement of activities and accomplishments, in which separate disclosure of specific factors influencing the activities of the Company is made, such as exchange rate fluctuations. The monthly report is integrated into the group quarterly reporting cycle, containing, in addition to information on the past month's performance, an "outlook" for the next one or two months, depending upon where in the quarter the Company is situated.

The KEY STATISTICS contained in the management report both by month and by quarter, are as follows:

[In the statements which follow, the following abbreviations have been used.

**OC** This stands for operating commitment, which refers to either a quarterly budget or monthly figure within that budget. These budgets are set prior to the start of a quarter and are unchanged throughout that period.

**OL** This stands for outlook, which is a budget revision figure drawn up as the quarter progresses to reflect changing circumstances. Thus at the end of month 1 of a quarter new "outlook" figures may be drawn up for months 2 and 3, giving a quarter outlook of month 1 actual plus months 2 and 3 outlook.

33
CASE STUDY - COMPANY A

AFP  Annual financial plan. Quarterly figures as incorporated into the annual plan, drawn up prior to the start of the year may be presented for comparative purposes.

<table>
<thead>
<tr>
<th>Key Statistics</th>
<th>Month</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>actual OC ER (*) operational budget difference +/-</td>
</tr>
<tr>
<td>Revenue</td>
<td></td>
</tr>
<tr>
<td>Margin</td>
<td></td>
</tr>
<tr>
<td>Plant expense</td>
<td></td>
</tr>
<tr>
<td>Incurred variances</td>
<td></td>
</tr>
<tr>
<td>Manufacturing period expense</td>
<td></td>
</tr>
<tr>
<td>Net inventory</td>
<td></td>
</tr>
<tr>
<td>Research and Development</td>
<td></td>
</tr>
<tr>
<td>Capital spend</td>
<td></td>
</tr>
<tr>
<td>Net cost of operations</td>
<td>(*) exchange rate</td>
</tr>
</tbody>
</table>

These statistics are followed by a management overview, which explains the underlying causes of any figures presented above.

The key statistics are extracted from a statement of operations for the quarter, which follows. In this, a more detailed analysis of the linkages between the margin, as presented above, and the net cost of operations is shown. To the actual figures for the current month are added the revised figures for the next one or two months (depending upon where in the quarter the reporting period ends) to give an
updated (OL) figure for the quarter, which is compared firstly with the budget for the quarter, (OC) and then with the relevant comparison from the annual plan (AFP). In this way changes in expectations are shown beside reported actual results. An extract from the statement would appear as follows:

Month-October

<table>
<thead>
<tr>
<th>Oct</th>
<th>Oct</th>
<th>+/-</th>
<th>Nov</th>
<th>Dec</th>
<th>Qtr 4</th>
<th>Qtr 4</th>
<th>+/-</th>
<th>Qtr 4</th>
<th>+/-</th>
</tr>
</thead>
<tbody>
<tr>
<td>Act</td>
<td>OC</td>
<td>OC</td>
<td>OL</td>
<td>OL</td>
<td>OL</td>
<td>OC</td>
<td>OC</td>
<td>AFP</td>
<td>AFP</td>
</tr>
</tbody>
</table>

Margin
Variances
R and D etc

The Company does not itself sell externally, all revenue being in the form of a transfer price, determined so as to recover all operating costs. Theoretically, the "bottom line," the net cost of operations, would be zero plus research and development costs. The statement concludes by detailing actual and budgeted inventory receipts for each month and quarter, and the plant overhead absorption out turn.

The same columnar format as illustrated above is used later when capital expenditures by sector are shown, and when a manpower analysis is given, employee numbers (direct and indirect) as well as variances being presented. The margin earned for each month is analysed later to show, by month and quarter, how it compares with the budgets drawn up on both OC and OL bases, and the physical product and revenue performance which underpins the reported and budgeted margin performances is shown.
CASE STUDY - COMPANY A

MONTH ACTUALS

<table>
<thead>
<tr>
<th>UNITS</th>
<th>REVENUE</th>
<th>MARGIN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Act OC Bud +/-</td>
<td>Act OC Bud +/-</td>
<td>Act OC Bud +/-</td>
</tr>
</tbody>
</table>

PRODUCT
A
B...

QUARTERLY BUDGET

<table>
<thead>
<tr>
<th>UNITS</th>
<th>REVENUE</th>
<th>MARGIN</th>
</tr>
</thead>
<tbody>
<tr>
<td>OL OC +/-</td>
<td>OL OC +/-</td>
<td>OL OC +/-</td>
</tr>
</tbody>
</table>

PRODUCT
A
B...

With substantial inventory balances, considerable attention is paid to monitoring the changes in inventory values and the analysis of cause as being due to operational or exchange rate factors. Inventory movement for each month is presented as follows:
CASE STUDY - COMPANY A

INVENTORY

<table>
<thead>
<tr>
<th></th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
<th>Qtr 4</th>
<th>Qtr 4</th>
<th>+/-</th>
<th>Exch R</th>
<th>Oper'l</th>
</tr>
</thead>
<tbody>
<tr>
<td>BALANCE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labour</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ Material ins</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ Overhead</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= Total inventory ins</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ Preproduction ins</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Product cost</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>+/-Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>+/-Exchange rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= CLOSING BALANCE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(*) The heading "other" collects the cost of items such as shrinkage, obsolescence, scrap and in transit costs.

From the above, the difference for any component of inventory between the quarter's outlook and OC budget can easily be identified, this variance being then broken down in the last two columns of the table into its exchange rate and operational causes.

Performance measures - non-financial

A major initiative in this area has been the development of a quarterly "Quality Improvement Programme" reporting package, in which various facets of the quality of the overall operation are analysed. The analysis shows the comparative figures for two years ago, last year, previous quarter, current quarter and current year end target, reported classifications being:

1. People quality
2. Design quality
3. Supplier quality
CASE STUDY - COMPANY A

4 Process quality
5 Product quality
6 Financial quality
7 Support quality
8 Cost of quality

Sub analyses, to one or two levels are carried out, so that under People Quality the first level of analysis is:

(a) absenteeism
(b) attrition
(c) appraisal
(d) training
(e) suggestion awards
(f) quality achievement awards

Taking "suggestion awards" as an example, the analysis then continues at a third level to show the participation rate, the number of decisions which have been made and the number of adoptions. The "total cost of quality" is the sum of prevention, appraisal and internal and external failure costs and the report includes comparative figures. These are of course financial figures, unlike the majority of the other figures in the cost of quality report, which are mainly non-financial, as when an assessment of 'Financial Quality' is made through consideration of statistics on forecast accuracy, new product cost projection accuracy and the external audit rating of the internal control function.

Of the non-financial performance indicators which were cited, quality was without doubt the core factor, being a major driving force behind change and a major factor to be considered in the implementation of change. In addition to the normal quality control and inspection procedures, the Company has added further assessment of "out of box quality" where a sample of finished
production is unpacked and re-inspected, and "arrival quality" where installation staff carry out a further quality assessment of shipped products. These assessments eventually appear on the Quality Improvement Programme report as percentages error free.

In addition to accumulating information on quality, the Company also gathers and uses information from a number of other sources. An analysis of customer perceptions of the Company has been commissioned, in order to gain an insight into the perceived strengths and weaknesses of the company by its customers. Of particular relevance in this context would be customer perceptions of both the adequacy and response times of the service function, which, as it operates on a worldwide basis, presents operational difficulties in the balancing of spare part availability with inventory minimisation. This customer perception information is regarded as being highly sensitive.

The Company runs a competitive equipment laboratory, in which competitors’ products are analysed and reported upon. The reports evaluate the strengths and weaknesses of the products of competitors, including engineering and costing analyses and reliability forecasts. The competitive analysis information is used in new product decisions to the extent that their specification is a function of the technical attributes of current products of both the Company and its competitors, the aim being to ensure that any new product represents an improvement on both. In general, it was felt that in the UK firms are relatively backward at using such competitive analysis information to aid prediction and decision making. An engineer must "take the lid off" the products of competitors, and predict what could be done to improve their performance, and what they will do next.

By performing a technical analysis of competitors' products, information can be gathered in areas such as the technical feasibility
of extending the products to embrace new functions and requirements. If this is not thought to be feasible, an additional measure of security is gained. Competitive analysis information may be difficult to interpret correctly however. An example was given of a competitor which produced a product which always beat that of the Company on cost of ownership criteria (cost of ownership including all costs associated with ownership such as purchase, maintenance, supplies and operator time cost). The competitor, totally unexpectedly, brought out a new product whose cost of ownership was higher than that of the Company's comparative product (the competitor had been investing in product quality to beat the Company on that criterion), but the Company had been focusing much of its effort on the problem of reducing the cost of ownership of its product. The finance function is not involved in competitive analysis, this being carried out by either technical or marketing personnel, the latter providing any necessary financial information.

New products are introduced through a five stage review process, the first two of which are concerned with the feasibility of the new product - a study phase, which concludes with a rough technical and financial justification of the product, resulting in an official project with a development budget. Development budgets at each stage require information on cost, reliability, expected sales price, expected volume and software requirement. The foregoing are interrelated. The content does not change between stages one and two, only the detail does. The second stage therefore produces more detailed targets, a closer look at the marketplace and a design. During stages one and two information is also being gathered on such items as requirements which cannot be met, necessary price reductions and product features which cannot be made. In phase three, models are built in order to run tests. Real output targets will be set, pricing decisions will be made, and a request for money for tooling will be prepared. Expenditure on tooling will have been taking place from the second stage, however, since even the test
CASE STUDY - COMPANY A

models cannot be built without some tooling. A go-ahead at this stage leads to an official marketing project (until the end of stage two marketing do not officially know of the new product), product announcement, production and release for worldwide distribution. Throughout the product's life there will thereafter be assessment of performance against pre-set targets, and the final stage at the end of the product's production life will be the termination review.

Economic environment and future internal developments

The status of the Company as a part of a group to a considerable extent conditions both the objectives of the Company and the information which it therefore uses. The external head office influence upon the Company is very significant with the head office's requirements determining how the Company behaves. Control is exercised through a Management by Objectives system, within which there are strong pressures to achieve the objectives, although the objectives themselves were sometimes not felt to be as appropriate to the long term interests of the Company as they might be: 'The emphasis should be less on doing things right first time and more on doing the right things right first time.' The major measurement item is what is concentrated on. It is critical to pick the correct measurements: 'What you measure is what you do?'. JIT was seen as a driving force in changing performance measures, stimulating a questioning as to whether the right factors were being measured.

There seemed to be a feeling that the objectives which were pursued tended to be short term, and that there was nobody at Company level who had formal responsibility for looking at the long term future. This omission had, in fact, been filled informally by the appointment of a manager, in house, with the specific remit to pursue more long term opportunities. Obtaining reliable information from the major
CASE STUDY - COMPANY A

markets is not easy, however, because although customers may project their future business plans forward for five years, they do not project their service requirements for a similar period, nor are they particularly forthcoming about products and features which they would like to see, generally viewing the provision of this information as something which should be suggested by equipment suppliers.

The Company operates on a build to order basis, the Marketing function, which is separate functionally and geographically, giving forecasts of what they think they can sell, this forecast plus firm orders being the basis on which requisitioning takes place. It was felt that the link between the Company and the external marketing function could well be strengthened to considerable advantage, since build to order is poorly linked to marketing, necessitating the requisitioning of materials based on the projection of a particular pattern of orders. A rolling forecast of demand is agreed every three months, but within that three month period the orders subsumed by the demand forecast may not be achieved or may be exceeded. This makes procurement relations with vendors difficult. Build to order requires accurate forecasts, and results are dependent upon forecasting. Forecasting is essential because of the lead time for components. As regards the customer, long lead times are not acceptable; the market for the equipment is becoming like a commodity market in which the customer will buy elsewhere if the delivery is insufficiently prompt. Since at any point in time the Marketing function will be at an unknown stage of "discussions" with potential customers, over time it would be useful to build up a model with the probabilities of success expected from any level of contact with the customer worldwide.

The organisation of product marketing might also be improved to focus responsibility more on products rather than on business areas, which has resulted in products sourced worldwide being marketed
CASE STUDY - COMPANY A

together, with no marketing responsibility for the specific products of the Company. While, as previously reported, an exercise has been undertaken to estimate the administrative cost associated with product change, better prediction of the cost of an engineering change would be useful. With operating lives spanning a number of years, subject to constant engineering change, there may be tens or hundreds of such changes. There is currently no mechanism which adequately costs such change; were such to exist there might be implications for, and changes to:

(a) design philosophy
(b) manufacturing change
(c) field maintenance

Engineering change, which is of increasing significance, creates obsolescence as well as incurring additional costs, primarily in the areas of personnel and in the procurement of new items.

Profits are expected to be generated from two sources, from the sale of equipment and from the servicing of that equipment, and it was felt that the gross margins achieved in these areas should be in balance. The profitability of servicing equipment was difficult to estimate, however, since there is a lack of information about the utilisation of equipment. The reliability of products can be estimated with considerable confidence, and this can be used in a maintenance service model, which results in decisions on product servicing such as product improvement to reduce servicing, product change to reduce the need for servicing and servicing simplification to allow user servicing. In order to be able to determine reliability before the event, field support information is critical. The Company must know the cost of servicing worldwide, and there is a Company manual which addresses how to assess the failure rate. Service profitability computation is not, however, simply a matter of the sales price of new parts less their cost, because other costs such as inventory
financing and storage costs must be included, and the more engineering changes there are, the more parts must be carried by the service engineers.

There is a lack of information about the utilisation of machines, and therefore on the closeness of fit between the theoretical model of utilisation and reality. The consequence is that the failures in the field may not always be those which are predicted. To provide for disparate rates of utilisation, maintenance logs are being built into equipment, and service engineers will soon be able to collect performance information direct from the equipment via a PC, and transmit it over the phone lines to the Company. At present the service engineers do not perceive the reporting of maintenance statistics back to the Company as being of the first priority. Accurate costings of the service function are important in order that life cycle costs can be determined for the use of both the marketing and servicing functions. The servicing of field equipment used to be a significant profit generator, but there is currently a problem due to third parties entering the equipment maintenance market, into which inroads have been made.

Some concern was expressed over the capital expenditure appraisal methods which are in use, justifications being based on Net Present Value, Internal Rate of Return and Payback. Capital expenditure approval has to be obtained from head office, the request for approval being based on both a technical and a financial justification, although it was felt that the technical justification had precedence and that head office tended not to question non financial justifications. Change in capital expenditure appraisal methods could not be implemented autonomously, as head office approval would be required. This could hinder experimentation.

Relevant factors in the capital investment decision include the fact that much capital expenditure relates to the release of new products
(such as tooling) and once a product itself has been justified further capital expenditure can be obtained by arguing that it is needed. Expenditure on development engineering can be justified by arguing that release will slip if the expenditure is not made, and a programme slip may have a big impact upon the organisation. There is a small part of the overall budget devoted to the development of new technology, the objective being to develop technology which has a planning period of greater than three years. The basic aim is to ensure that the technology meets a product need and ensures that the Company keeps up with competitors. There is little detailed financial justification required for this category of cost apart from a general justification of the cost of developing the technology and an assessment of its eventual impact on product costs.

There is some unease over the use of "hard and fast" financial inputs such as discount factors and hurdle rates, and there was a feeling that while these measures might have been useful in the past, in today's more complex environment capital expenditure justification needs to be re-examined so that the financial input is no longer relegated to the secondary role to which the present techniques consign it. Financial management, in this area, is on the sidelines because it has disengaged itself from operational support by requiring that all factors be quantified in financial terms before being operationalised. Possible advances in this area might include introducing probabilities into capital expenditure appraisal so that a better understanding of the range of probable financial outcomes can be obtained, and a development of systematic post audits, so that the efficiency of the original capital budgeting decision model can be tested. Capital expenditure appraisal highlights the communications gulf which can separate the financial from the operations personnel. There was a need for the communities to understand each other's problems better, and thereby for operations personnel to make better use of more relevant financial information, so that, for example, the present ex-post analysis of expense incurred against budget could be changed.
to a more useful ex ante management tool for the better control of programmes.

The performance objectives which were cited as being significant varied according to the particular responsibilities of the person being interviewed, but the achievement of overall quality, reductions in lead times and inventory turnover, control of unit product cost, plant overhead and research and development expenditure and the reduction in batch sizes for purchase orders were quoted. Some of these are related to the development of JIT in the plant, which has been successfully introduced at little cost and is being expanded to embrace additional areas of activity. As the implementation of JIT increases, so the performance measures which are currently used within the company will also have to change.
CASE STUDY - COMPANY B

Company B is a medium sized manufacturing company. It is an old established firm which operates in a competitive but cyclical market characterised by pressure on profit margins, and in which high levels of capital investment are required in order to support the introduction of both new technology and new capacity. Trading is effected through a group structure, in which the holding company and a small number of primarily wholly owned subsidiaries sell a range of related products to a number of markets. Company activities are based on two related "core businesses" and the Company has a declared intention to maintain this focus, having stated that, "investment will normally only be made into these businesses and businesses closely related to them". This focus, while conferring obvious operational and control advantages, also brings with it the attendant problems associated with the cyclical nature of the sector, and the Company has suffered in the past from down turns in the economic cycle. The aim of the Company is not to be simply a "player" in a number of risk-diversifying negatively related markets, however, but to be a significant supplier of specifiable products in its chosen markets; to supply at the highest quality level; and to be competitive with the best international standards. This commitment to quality was very strongly expressed both in interview and in stated corporate goals, where the first statement reads "Service to our customers is the focus of all our efforts. We can only succeed by serving others—our customers—better than any other supplier."

The emphasis on quality is operationalised by the capital investment programme, which has, for example, resulted in a product range which has been expanded by the addition of a new product at the top quality end, and by the emphasis given to quality improvement in reviewing the results of capital expenditure. With pressure on margins, increases in quality improve the marketability of the product, and also, through their effect on yield, increase the volume of saleable output.
CASE STUDY - COMPANY B

Objectives

The Company has objectives in a number of areas apart from service to customers. The financial objectives are threefold, (i) to make a return on capital which marginally exceeds the interest rate, (ii) to raise profits by at least x% in real terms, and (iii) to ensure that gearing remains below a specified and moderate level. In addition to the financial objectives, the Company has a number of stated objectives in relation to its employees, for whom it regards active involvement in the business as being of the highest importance. Employee involvement with the Company is actively sought through the implementation of a number of stated principles; in all dealings with people anywhere, observing the highest standards of honesty and fairness; providing excellent levels of rewards and working conditions; aiding and encouraging all individuals to develop and exercise their talents to the full; promoting teamwork and expecting all individuals to carry out their work at a high level of competence. Communication of information about the progress of the company is achieved by monthly briefings, through which information is disseminated to all staff, as well as through a periodic company newsletter. Employee perceptions of the company have been sought by means of an externally conducted attitude survey, which analysed and reported to management on the opinions expressed by a large sample of employees. The employee remuneration package includes, in addition to the contractual payments, two profit sharing schemes, one of which pays out a cash bonus while the other issues shares to eligible employees. By these means the notion of a "shared enterprise" may be created, in which the traditional conflict of interest between the employee and the employer becomes increasingly redundant. The responsibilities of the company towards its employees are mirrored to some extent by its attitude towards its shareholders, whose interests the profit sharing schemes are designed to harmonise with those of its employees. The same standards of fairness and equity which the Company holds to be important in
dealings with employees, are important in relation to the shareholders, who are to receive a "fair deal". The Company is independent, a situation which it would like to continue, this being a stated "ownership goal", and it has a capital structure which supports the maintenance of the status quo.

Performance measures - financial

There is a quarterly formal review of performance, while strategy is reviewed annually. Among the performance measures which are used are the following:

(a) Return on capital.

(b) Return on sales. This ratio is seen as particularly significant.

(c) Value added per £ of sales. Value added also appears in the annual review of operations which is issued to each employee. In this review the profit and loss account shows external costs and depreciation being subtracted from income from sales to highlight net value added, which is then analysed into the portions going to wages, salaries and benefits, corporation tax, dividends and retentions.

(d) Gearing. Although the Company is not highly geared, the low margins combined with the high levels of capital expenditure bring to prominence the management of debt. The plant used in this industry tends to be very expensive, so that considerable sums of money are involved in the capital programme, particularly due to the commitment to improving quality and the expansion of capacity.
(e) Cash flow. Cash is regarded as being as important as profit, and actual cash flows are compared with those which have been budgeted. The monthly income statements, produced for the holding company, the divisions and the group, merge profit reporting with 'cash flow' reporting as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales - External</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Inter group</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>less: Std Cost of Sales</td>
<td>(*)</td>
<td>(*)</td>
</tr>
<tr>
<td>Std Gross Margin Variances</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>less: Operating Expenses</td>
<td>(*)</td>
<td>(*)</td>
</tr>
<tr>
<td>CASH FLOW</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>less: Depreciation</td>
<td>(*)</td>
<td>(*)</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>less: Working capital interest</td>
<td>(*)</td>
<td>(*)</td>
</tr>
<tr>
<td>Bank interest</td>
<td>(*)</td>
<td>(*)</td>
</tr>
<tr>
<td>NET PROFIT</td>
<td>*</td>
<td>*</td>
</tr>
</tbody>
</table>

The holding company is credited with the working capital interest which is charged to the divisions, so that in the statement for the group the two figures cancel out.
(f) **Causal analysis.** A monthly and year to date analysis of the causes of differences between the budgeted and actual sales and budgeted and actual pre-tax profits is carried out for the divisions, the holding company and the group. An example of the format of the reporting would be as follows:

<table>
<thead>
<tr>
<th>May 90</th>
<th>Division A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sales</td>
</tr>
<tr>
<td></td>
<td>£</td>
</tr>
<tr>
<td>Actual</td>
<td>*</td>
</tr>
<tr>
<td>Budget</td>
<td>*</td>
</tr>
<tr>
<td></td>
<td>a</td>
</tr>
</tbody>
</table>

**Causes:**
- Volume
- Sales mix
- Sales price
- Cost inflation
- Performance
- Currency
- Stock revaluation
- Working capital interest

The budget/actual sales and profit variances are first broken down to show the effect of variances in sales volume, sales mix and sales price. These variances completely explain the difference between actual and budgeted sales, but the difference between the respective profits is also influenced by cost

51
CASE STUDY - COMPANY B

variations, these being analysed above. The influence of inflation is apparent, cost inflation being separately identified, but inflation also influencing stock revaluation, currency movements and interest rates. In interview the importance of taking account of inflation in the monthly accounts, by using deflated numbers, was stressed.

(g) Ratios per employee are produced such as sales and profit to highlight the productivity of labour.

Performance measures - non-financial

The non-financial measures which are produced reflect the Company’s concern with its performance in the market. Market share statistics are gathered and the sales growth rate is monitored. A weekly business report is produced, in which volume sales by business group are presented in the form of a graph of five week moving averages of current year, prior year and current year budgeted figures. Information on competitors is obtained not only through the normal industry based sources but also from a commissioned consultancy. Information on competitors is extracted from publications such as the "Investor’s Chronicle" and is circulated to senior management, but as the number of independent companies in the market reduces through takeover activity, this kind of information source is drying up. The group board is more concerned with long term trends than with short term matters, and it was stressed that long term performance, rather than short term results, was seen as important. The long term outlook is evidenced in the heavy capital expenditure commitments, in the corporate objectives, which are focused on making the Company a greater force within its industry, by the effort applied to harmonising and strengthening the links between the employees and the Company and by references to the tradition of independence which the Company has benefited

52
CASE STUDY - COMPANY B

from, and which it intends to maintain.

Economic environment

The Company has a product cost breakdown which is almost 50% material, much of this being imported. It also holds significant stock levels, particularly of raw materials and finished goods. Demand for the finished product is influenced by movements in the Gross National Product (GNP), but the market is more volatile than is the GNP. In this environment, good forward information on currency rates and on interest rates would be extremely valuable. The Company would also like better information about market share, and, most importantly, would like up to date information about stock levels, both in the industry and of worldwide raw materials.

The emphasis on gathering useful external information is seen as being to some extent relevant to the needs of stakeholders, and greater reference in annual reports to the market and to competitors was stated to represent a potential improvement on current practice. Internally, flexibility was to be encouraged, so that systems do not become over formalised and static. There was, for example, a trend currently for monitoring of performance to be increasingly based on non-financial measures rather than on the traditional financial model. Although the collection and analysis of data is important, and considerable emphasis is placed on attempting to isolate "trends in depth", it is important to bear in mind that it is operations which create the numbers and ultimately to which attention must be directed.
CASE STUDY - COMPANY C

Company C is a large public group operating in both the manufacturing and service sectors. It is an established group with many well known brands. Within the group each business is viewed as being autonomous with its own debt, equity, cash flows and profit. For example, both the debt level and interest level are reported for each business.

Objectives

The budget cycle is driven centrally on the basis of two main financial objectives:

1. growth in earnings per share;
2. growth in return on investment.

Top management believe that outsiders assess the performance of the group mainly in terms of the above two objectives. An important criterion for the Group is to avoid the dilution of earnings per share and any project must overcome such dilution within two years. Three different group directors expressed concern at the problem of the short-term view of the City. The directors considered that this short-termism makes it difficult to develop a new business and to take the long-term view because of the emphasis on one year's performance. Three important subsidiary financial objectives are established in terms of:

1. growth in pre-tax profit;
2. level of cash flow;
3. level of capital expenditure.

Other key performance indicators which are used include gross profit per unit and cost to sales. These and other details on the performance of the various businesses within the group are maintained on a database which is monitored closely by an Operations Committee.
CASE STUDY - COMPANY C

However, it would be wrong to infer that the business is driven by numbers. The three year planning cycle is based on general business direction and philosophy - for example targeting specific business sectors for expansion. The budget cycle is driven down vertically but great efforts are made to ensure commitment at each level of the group. Capital expenditure is controlled by authority levels, employee remuneration is controlled centrally but pricing decisions are delegated to local level, although national brand pricing decisions are subject to an overview from the Group level to ensure that there is consistency in pricing policy.

A corporate development department has been established centrally mainly because of the pressures on the management time of group directors who are also chairmen of the operating companies. However, those in the corporate development department always have several years' experience in the operating companies. The objective of the corporate development department is to maximise the shareholders' value by identifying potential companies which might be acquired outside the core manufacturing industry. Obviously with such sensitive information, much of the work of the corporate development department is highly confidential. The general criteria for acquisitions outside the core manufacturing business would include:

1. growth market;

2. sufficient scale of operations to have a significant effect on the group's financial results;

3. cash generator;

4. service sector;

5. relatively unstructured sector with fragmented base of suppliers.
CASE STUDY - COMPANY C

Performance measures - financial and non-financial

In addition to the monthly reporting of profit and cash flow, the group has a quarterly business review procedure when one day is devoted to each business. This quarterly business review includes non-financial performance measures such as the trends in market shares in various business sectors. Furthermore, the directors emphasised the importance of explanations and non-financial information to help them to analyse the real performance of the various businesses and to enable the directors to obtain an accurate overview of the group. However, the non-financial performance measures are given an even higher priority in the weekly business review. The financial measures such as return on capital are viewed as the end results stemming from the non-financial performance measures. The non-financial measures are used to manage the various businesses. For example, in the weekly business review the trend in the volume performance is closely monitored and compared with the corresponding week for the previous year.

One particularly interesting area of the performance reports concerned the development of new and existing brands. The investment in brands (such as advertising and marketing) is reported but the capital investment is not brand specific because with flexible manufacturing the same production facilities can produce several different brands. Brands are assessed in terms of both financial and non-financial performance measures. For example, one important financial measure is the contribution (ie sales less variable costs) of each brand. In addition to assessing each brand’s contribution an attempt is also made to measure each brand’s profit. The investment in terms of promotion and advertising is also monitored on a £ per unit sold basis. The profitability of the various brands is reported in a matrix format showing for example the profit from selling a particular brand to a specific customer. Brand variances are also analysed by various factors such as price and volume. The managers
emphasised the importance of ensuring that brand values are increasing.

Two important non-financial performance measures for brands are each brand's sales volume and also the "standing of each brand". The brand standing is assessed by means of market research involving interviews with members of the public. The respondents are asked to rate competing brands (including the group's own brands as well as those of competitors) against a number of specific aspects of the brands on a 1 to 10 scale. The results are tabulated as follows:

<table>
<thead>
<tr>
<th>Aspects of brands assessed</th>
<th>X</th>
<th>Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brand A</td>
<td>5.3</td>
<td>2.1</td>
</tr>
<tr>
<td>Brand B</td>
<td>1.2</td>
<td>6.7</td>
</tr>
</tbody>
</table>

By means of such a table an assessment can be made of how the group's brands compare with the brands of competitors. Information can therefore be reported on:

1. the brand awareness of customers;
2. the 'standing of the brand';
3. the preferences of customers.
CASE STUDY - COMPANY C

Economic environment

The economic environment is monitored to assist with the overall market forecast. This includes a detailed examination of demographic trends, unemployment and earnings growth on a regional basis as well as general intelligence on the market including surveys of factors such as social attitudes. Specific large customers are also analysed very closely. Changes in the market itself are, of course, also monitored including customers’ preferences for particular types of product, shifts to premium products and the relative importance of different channels of distribution. Surprisingly in one particular line of business because of the distribution network it is actually difficult to determine who stocks the group’s products at the retail level. In certain lines of business it can be difficult to determine accurate market shares. However, information on various aspects of the economic environment is generally available at a price with the main constraint being the willingness to spend money on purchasing the information.

The group does undertake competitive analysis covering competitors’ products, advertising, quality of service, product plans, stock exchange share performance, price-earnings ratio and dividend policy. Information is used from public sources (such as published financial statements), subscription to database services (such as market share and market performance data), industry statistics (such as data exchange on quality specifications) and own employees (such as general knowledge of the industry, informal contacts and estimates of the cost structure of competitors). Local managers and salesmen provide useful information on competitors. A key piece of information is the discount which competitors are offering to customers because this usually varies on a region by region basis. Detailed financial information about the subsidiaries of major groups can also be difficult to determine with any accuracy. Although a combination of financial and non-financial information is used in
this competitive analysis process, generally the non-financial information is more important.

The problem of disclosing information to institutional investors was highlighted. Fair disclosure to all shareholders was emphasised but more detailed explanations were given to institutional investors. Indeed institutional investors talk to a wide cross-section of management and the directors of this group suspect that some companies are disclosing confidential information to institutional investors.

The directors interviewed would generally not be keen on publishing their specific internal management forecasts because of the perceived over-reaction of the Stock Market to such forecasts. However, the benefit to shareholders of publishing profit forecasts was agreed although again this would cause problems for managers and probably change the internal forecasting system. The group does at present release press statements in general terms about its plans and future business developments. It was agreed that general market trends and structural information could be disclosed because the activities of the group should be placed in their proper context. The disclosure of more detailed brand information met with a mixed reaction. It was accepted that it would be more useful to institutional investors to disclose brand margins than to capitalise brands in the balance sheet. However, it would be difficult to compare such brand margins with those of competitors unless a specific measurement approach was agreed with some fairly detailed guidelines.
CASE STUDY - COMPANY D

Company D is a large company in the service sector. It is a well established company with a household name. The Group consists of six different divisions operating in closely related markets. The major functions at head office include finance (which has responsibility for strategic planning), personnel and property.

Objectives

The two overriding group objectives are:

1. to maintain consistent growth in earnings per share;
2. to avoid diluting the ownership of the ordinary shares.

The other two main objectives are expressed in terms of return on capital and capital gearing. The group has a small strategic planning unit reporting to the Finance Director. A database with a ten year historical record and a five year forecast is used as part of the strategic planning process. However, great efforts are made to develop strategic awareness in the operating divisions and indeed any new strategy is worked through with the divisional managers. For example, coordinated market research will be conducted at both the group and divisional levels.

Linked to this strategic planning process is the annual planning cycle. Again it will begin with a top down approach with head office issuing guidelines outlining the major issues for the divisions to consider. This first part of the annual planning process is general for all divisions. The second part of the planning process is a reappraisal stage with a predominantly bottom up approach. The third part of the process is a full strategic review updating the five year plan on a rolling review basis. In future the Group wishes to move away from this annual planning cycle because it wishes to emphasise the importance of divisional managers thinking strategically and hopes in future to use the rolling review of the strategic plan to replace the
annual planning cycle. However, at present, at the end of this planning process, at Group and Divisional level there is a three year plan with the first of these three years used as a control budget in the performance reports. This three year plan is updated periodically to give a two year rolling forecast.

Performance measures - financial and non-financial

The Board of Directors for each Division meets one week after each month-end and the Group Board meets monthly three weeks later. For each Division a monthly summary is prepared for the Group Board Meeting. This Division Results Summary (see Exhibit 1) includes:

- Turnover and growth in turnover
- Gross margin (percentage and pounds)
- Total costs
- Trading profit

(a) for the month in comparison with the budget and also with the same period last year;

(b) for the year to date, again in comparison with the budget and also with the corresponding period last year;

(c) for the full current year both in terms of the original budget and in terms of the latest forecast.

A performance summary is also prepared for each Division (see Exhibit 2). Exhibit 1 therefore gives the impression that the
CASE STUDY - COMPANY D

Division Results Summaries are entirely financially based. However, a crucial element in this reporting package is that each Division's Group Board Director reports to the Group Board directly on the non-financial issues.

Four main non-financial areas are reported regularly to the Group Board. Firstly, progress on information technology and other productivity improvement initiatives is closely monitored. Some information technology developments can give the Group an important competitive advantage. Secondly, any apparent changes in customer behaviour are highlighted because it is crucial for the Group to react quickly to such changes. A third non-financial aspect reported to the Board is that of employee relations. Such a report may include some quantitative measures but basically it is a qualitative report. Fourthly, changes in the property market are closely monitored by the Board because such changes may affect both the direction and timing of future expansion plans for the Group.

Just as the Division Results Summaries can give the impression of being entirely financially based so can the rest of the package for the Group Board. The Group Performance Statement (see Exhibit 3) includes:

- Turnover and growth
- Profit before tax in pounds
- Profit before tax growth in percentage terms
- Profit before tax growth expressed as a percentage margin on sales
- Earnings per share
CASE STUDY - COMPANY D

Earnings per share growth in percentage terms
Dividend per share in pence
Dividend per share growth in percentage terms
Dividend cover
Ordinary shareholder funds in pounds
Return on ordinary shareholder funds in percentage terms
Gearing at the year end in percentage terms
Interest as a percentage of pre-tax profits

and all the above are shown also for the previous four years, the current year’s budget and the current year’s latest reforecast. In addition to this Group Performance Statement, the Group Board also receives:

1. a Group Balance Sheet at the end of the latest month together with the budget variance and also the latest forecast year end balance sheet together with the budget variance;

2. a Group Profit and Loss Account (including extracts of sales and profits by division past month, the past quarter and the latest forecast for the current year with all three also showing the variance from budget);

3. a Group Financial Statement for the year to date and also the latest forecast for the current year with the presentation of this Statement being in terms of the closing cash book balance and the Statement including the total for unpresented cheques;
CASE STUDY - COMPANY D

4. the latest forecast changes to the original budget;

5. an interpretation section and comments on the above financial results giving reasons for any significant changes.

The main features of this reporting package to the Group Board therefore are the emphasis on financial performance measures, the importance of non-financial factors in the interpretation section and the very extensive use not only of budgets but also of the monthly reforecasting process. This is a good example of the use of feed forward control.

Economic environment

Each year this Group conducts a major non-financial review of various aspects affecting its business such as how the various markets will develop and also conducts a financial and non-financial review of its competitors. This Group operates in certain markets which tend to be relatively stable for a period of years followed by sudden potentially catastrophic changes. For example, the most recent change involved a major reduction in the number of smaller competitors in one particular market. The Group therefore tries to anticipate these sudden changes but this is extremely difficult to do successfully because of the unpredictable nature of these changes. Nevertheless an attempt is made to forecast potential takeovers, mergers and new entrants in the Group's various markets.

In addition to such analysis of competitors, this Group also conducts a detailed analysis of suppliers and developments in the markets of such suppliers. Generally trading relationships with suppliers tend to be long-term but this Group monitors all new entrants into its supplier markets. The impact of demographic changes is monitored with regard to the effect on the future supply of employees. Other
important variables which this Group monitors are the level of consumer spending, the average take-home pay and any apparent changes in consumer spending patterns. Information about different geographical regions is also important for decision-making within the Group. Indeed this Group would like a lot more regional information but at present it is not available in any reliable form. Similarly, many government statistics on the market tend to be in the wrong categories for this particular Group which finds it difficult to determine accurately the growth and therefore its own share of certain of its markets. Again this lack of reliable information can affect decision-making.
<table>
<thead>
<tr>
<th>PERIOD 6 WEEKS</th>
<th>DIVISION RESULTS SUMMARIES</th>
<th>CUMULATIVE 12 WEEKS</th>
<th>52 WEEKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACTUAL</td>
<td>WAR FROM BUD</td>
<td>LAST YEAR</td>
<td>AS AT</td>
</tr>
<tr>
<td>%</td>
<td></td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>M. A. T.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CURRENT MONTH</td>
<td>YEAR END</td>
<td></td>
<td></td>
</tr>
<tr>
<td>--------------</td>
<td>----------</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>BALANCE SHEET</td>
<td>LATEST</td>
<td>PREV</td>
</tr>
<tr>
<td>ACTUAL</td>
<td>BUDGET</td>
<td>PICAST</td>
<td>PICAST</td>
</tr>
<tr>
<td>Tangible Fixed Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debtors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intangibles</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NET WORKING CAPITAL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NET OPERATING ASSETS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Profit</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bad Debts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NET INCOME</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NET CAPITAL EMPLOYED</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MANAGEMENT PERFORMANCE</th>
<th>LATEST</th>
<th>PREV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Net Operating Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Post interest)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Funds Generated</td>
<td>1000</td>
<td></td>
</tr>
<tr>
<td>(Post interest)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment Costs as % of Sales</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trading Profit Margin</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>Delinquent Weeks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CASE STUDY - COMPANY D</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GROUP PERFORMANCE STATEMENT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-----------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Profit % of Pre Tax Profit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Year End %</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Earnings</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Ordinary Shareholder's Funds</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend Cover %</td>
</tr>
<tr>
<td>Dividend Expenditure %</td>
</tr>
<tr>
<td>Dividend (Cash) %</td>
</tr>
<tr>
<td>Earnings Cover %</td>
</tr>
<tr>
<td>Earnings (Cash) %</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>PER ORDINARY SHARE (with Preference Dividends)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin %</td>
</tr>
<tr>
<td>Dividend %</td>
</tr>
<tr>
<td>Cash Flow %</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Profit Before Tax</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
</tr>
<tr>
<td>2017</td>
</tr>
<tr>
<td>2018</td>
</tr>
<tr>
<td>2019</td>
</tr>
<tr>
<td>2020</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Turnover</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
</tr>
<tr>
<td>2017</td>
</tr>
<tr>
<td>2018</td>
</tr>
<tr>
<td>2019</td>
</tr>
<tr>
<td>2020</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Budget</strong></th>
<th><strong>Forecast</strong></th>
<th><strong>Latest</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>2017</td>
<td>2018</td>
</tr>
<tr>
<td>1980/81</td>
<td>1981/82</td>
<td>1982/83</td>
</tr>
<tr>
<td>1983/84</td>
<td>1984/85</td>
<td>1985/86</td>
</tr>
</tbody>
</table>

**GROUP PERFORMANCE STATEMENT - JULY 2020**
CASE STUDY - COMPANY E

Company E is a small manufacturer within the electronics sector, having, therefore, like most firms in this industry, a short history into which is packed considerable change—in this case not only market and technology driven change but also financial and organisational change. The Company is expanding, and operationally occupies a market niche at the quality end of the production spectrum, developing a capability for manufacturing high quality complex products at the "leading edge of technology". This emphasis on quality enables the Company to obtain a premium price in the market. A preoccupation with quality was evidenced in all the interviews conducted, quality being seen as the "profit driver" of the Company, since it differentiates the Company's products from those of competitors, and thus can bring in new business. Quality is seen to relate to much more than excellence in manufacturing, also embracing the full range of relationships which the Company has with its customers. Recognition of product quality is evidenced by the fact that despite increasing product complexity, "ship to stock" agreements with customers are being introduced, whereby products delivered to customers are not further tested prior to assembly.

The company has no real UK competitors within its market niche, but there are many producers within the overall market. Although there are several hundred manufacturers in the market, (as there are also in, for example, France and Germany), in the UK the largest eight manufacturers account for approximately 80% of the overall volume. There are significant direct overseas competitors, however, some of whom it was felt may benefit from more favourable financial environments and available business incentives. Overall, the market is very competitive, particularly at the lower end. There are therefore good reasons for differentiating the Company from the rest of the competition. The customer base is relatively compact, with the majority of the business coming from about 15 customers, located within Europe. More than half of production by value is exported, a proportion which is increasing. This has made the opening of the European market in 1992 "something of an
irrelevancy" as far as the Company is concerned, since it already has strong European connections.

Objectives

Company objectives are primarily concerned with (i) developing the technology and improving quality, (ii) maintaining and developing the customer base, and (iii) maintaining a sound financial profile. The Company, in furtherance of the first objective, has initiated a Just In Time project, through which an external consultant, working closely with the Managing and Production Directors, has over the past 18 months implemented a Just In Time (JIT) manufacturing system. This is designed to speed up the production process, thereby increasing factory capacity and providing a greater degree of flexibility both internally and to its customers. Despite the emphasis on quality, the Company does not have a large number of inspectors at each stage in production, each employee instead being trained in the importance of quality and being responsible for the quality of his/her own output. This is referred to as Total Quality Management.

Product development is generally undertaken in conjunction with customers, through in-house research and development activity. By this means both products and manufacturing performance will be improved. Some of the customers are considered to be technology drivers, and the co-operative development work which is undertaken with them is a key ingredient in corporate strategy. The introduction of JIT has enhanced the level of service offered to the local market, which has benefited from significantly reduced lead times. A recent innovation, which is being developed, is a production unit with dedicated equipment and employees whose function is to support customer development programmes and to perform "pre-production" manufacture of small quantities of product on a very short time scale. Any improvement in customer service is seen as important,
CASE STUDY - COMPANY E

given the market in which the Company operates and the joint nature of the development work with customers. Notwithstanding the high reputation which the Company has built, customers frequently require competitive tendering, so that the price and performance package offered must remain attractive.

The financial structure of the Company requires close attention, being relatively highly geared as a result of past strategic decisions. The gearing has subsequently been systematically reduced, but the requirements of the capital expenditure programme, the expansion of business and the objective of debt reduction have to be carefully balanced.

Performance measures - financial

The financial performance of the Company is represented principally through a monthly board report, which is distributed to board members and to senior managers. This package, which goes into considerable detail, is produced within six working days from the end of each month, and is seen to confirm the ability of the accounting department/system to produce relevant and timely information. The reporting format comprises:

(a) Profit and loss account

(b) Balance sheet

(c) Cash flow

(d) Commentary

The first three of the above items are produced on a consolidated basis for the Company as a whole, and then analysed for individual
components. For each month, budgeted and actual profit and cash flow figures are shown, as are year to date budgeted and actual figures.

In the commentary accompanying the financial statements, certain of the actual figures are compared not only with their budgeted equivalent, but also with recent forecasts. Thus in respect of sales, the following format is shown:

**SALES REVENUE**

actual £x,(n equivalent units/week x 4 weeks x £p average/eu)

budget " "

forecast " "

Plant production variances (a standard costing system is in operation) are shown as actuals in relation to both budgeted and forecast costs, and a profit reconciliation is shown in relation to both budgeted and forecast profits:
CASE STUDY - COMPANY E

<table>
<thead>
<tr>
<th>£k fav/(adv)</th>
<th>to budget</th>
<th>to forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>budget/forecast profit</td>
<td>a</td>
<td>b</td>
</tr>
<tr>
<td>sales volume</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sales mix</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sales margin mark-up</td>
<td></td>
<td></td>
</tr>
<tr>
<td>production variances (1)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>actual profit</td>
<td>p</td>
<td>p</td>
</tr>
</tbody>
</table>

(1) This item is analysed out by cause in a supporting schedule.

A number of budgeted and actual working capital indices are presented, (stock turnover and debtors and creditors ratios), and forecast and actual debt to equity ratios are presented, along with the upper limit to this ratio.

In discussion, considerable emphasis was placed on the need for product quality, and in support of this thrust a quality cost statement is produced each month, giving an analysis of the "cost of quality" for each month, year to date and prior year total. The headings used, and their subdivisions, are as follows;
CASE STUDY - COMPANY E

COST OF PREVENTION

process control
quality assurance plus management
J I T
other
TOTAL

COST OF APPRAISAL

final inspection
in process inspection and test
other
TOTAL

COST OF FAILURE INTERNAL

scrap
remakes
write offs
other
TOTAL

£k %

75
CASE STUDY - COMPANY E

COST OF FAILURE EXTERNAL

lost sales

customer returns scrap

other

TOTAL

TOTAL COST OF PREVENTION

TOTAL COST OF APPRAISAL

TOTAL COST OF FAILURE INTERNAL

TOTAL COST OF FAILURE EXTERNAL

TOTAL QUALITY COST £ 100%

TOTAL QUALITY COST

as % cost of sales

as £/equivalent unit cost of sales

ACTUAL MARK UP

MARK UP EXCLUDING QUALITY COST

MANUFACTURING CYCLE TIME (DAYS)
CASE STUDY - COMPANY E

The above report measures, in considerable detail, the cost of scrap and the cost of quality monitoring. It is prepared in order to focus attention on the cost of substandard work, and allows the effect of changes in the cost incurred in respect of one of the variables to be assessed by way of compensating cost changes elsewhere. The actual relationships are in practice not always clear, however, but in principle, after a period of training, each £1 spent on quality monitoring should save more than £1 in scrap.

The Company produces a detailed analysis of sales each month, in a format which allows geographical and product performance to be identified on both a current and year to date basis.
CASE STUDY - COMPANY E

MONTHLY SALES ANALYSIS

----- REVENUE ----- ---- MARK UP ----

<table>
<thead>
<tr>
<th>Product Geographical Area</th>
<th>Bud Act Month</th>
<th>Bud Act Ytd</th>
<th>Bud Act Month</th>
<th>Bud Act Ytd</th>
</tr>
</thead>
</table>

1

2

TOTAL

SUMMARY

UK

EXPORT

TOTAL

An interesting feature of this presentation is that the area analysis treats UK key customers as a separate "area," which enables the revenue and mark up performance of this group to be separately identified. The detailed sales analysis is then continued by means of a series of matrices which, monthly, by product group, show:

(i) sales in equivalent units per week
(ii) sales revenue per equivalent unit
(iii) mark up on standard
CASE STUDY - COMPANY E

Having analysed the price and profit performance aspects of the product sales, the marketing expense itself is subjected to a similar treatment, monthly and YTD budgeted and actual figures for sales expense in various sales areas being shown. As a development of this analysis, sales costs for certain areas of activity are shown as percentages of the revenue for these areas.

Detailed monthly figures are also presented to the board which show the production costs which have been incurred in achieving the gross margin, a breakdown of overhead costs (classified as fixed or variable) and the usage of consumables by budget centre. In addition, Profit and Loss Accounts, Balance Sheets and Cash Flow Statements are presented, both for divisions and for the group. As an expanding company with limited finances available, the importance of tight financial controls was emphasised, with cash management being particularly important.

With such a wealth of financial information on hand, it is interesting to note that the Financial Director maintains much of the information on a series of flipcharts in his room. Each month the various flipcharts which give an immediate financial history of the year’s performance are updated to reflect the most recent results. Simple, but effective, the flipcharts act as visible focused sources of information useful for monitoring and highlighting aspects of performance, and enabling a group to concentrate its attention more effectively on a particular area of interest. Although satisfied with the information which the accounting system provides, some changes were contemplated. The information on the cost of quality and its reporting is to be developed further, since this area is seen as a critical success factor, and the costing system is to be simplified, as too much administrative time, it is felt, is spent on tracking product movement through the plant. This simplification might cause the number of cost centres and of levels of standard cost application to be reduced.
CASE STUDY - COMPANY E

Performance measures - non-financial

Certain key figures are used in the day to day running of the business. Of particular importance is the daily output figure (equivalent units), and the computer system is capable of providing statistics on production, by cost centre, on a daily basis. On-line information is available on each batch of product at each production process. Daily figures are available for standard hours worked, products produced and order input. Certain production cost centres are seen as bottlenecks, and the movement of WIP is monitored so that a build up of production at these bottlenecks is avoided. This might require the re-scheduling of production to avoid the bottleneck, or a pulling forward of production to ensure that the bottleneck is kept occupied. Each morning, a printout of the physical quantity of WIP at each cost centre is produced, which highlights the location of potential capacity problems in time for them to be dealt with. Another report, produced daily, gives the output of each cost centre in equivalent units as well as the daily target for the particular cost centre. There is a minimum daily output figure which should always be exceeded, this being related to the maximum output which can be expected from the bottleneck cost centre.

The scrap generation is monitored if the value of the scrap is above a certain daily figure, and the trends in scrap generation are looked at. Trends in scrap generation are studied because otherwise it is felt that recurring minor scrap which nevertheless in the long run has a significant cost, could otherwise be overlooked. A major element in the Cost of Quality Report is scrap, therefore the scrap report goes into considerable detail, showing for material the quantity scrapped and for both parts and material the cause and value of the scrap and the % of the total scrap value which each cause represents. The six major causes of scrap on a five day cycle are separately identified. Despite the close attention given to monitoring and to preventing
wastage, the actual level of scrap is not falling, due to the constantly increasing complexity of the product and the reducing tolerances which must be worked to. Scrap, which is the most significant element in the cost of quality, influences yield levels, which in turn influence costings. Competitive analysis is not difficult to the extent that the technology and equipment used is not exclusive to this Company, and the products can be in most cases readily obtained, but without yield figures competitors are unable to determine the Company's costs.

The marketing function, like production, makes extensive use of the computer facility, and has plans to increase its computer usage in the future. Each month a sales analysis is undertaken, where sales by part number are analysed (last month’s actual and the next five months’ forecast). This analysis is exploded out to a material requirements schedule and standard hour requirements (MRP system). Bottlenecks are thereby identified, and plans can be made to reduce their effect, either by modifying the production plan or by modifying customer requirements. All production is bespoke, therefore there are no finished goods stocks, and materials are only ordered against known orders or good forecasts. With lead times dropping and JIT production and purchasing being introduced, attention is being drawn to the problem of getting suppliers to meet the Company’s requirements, and to make more regular deliveries of smaller lot sizes.

Market information comes largely through the Company’s own intelligence gathering system, supplemented by published forecasts and trends. The marketing department looks at geographical area analyses, market sector information and leading indicators for up to four years in advance, as well as an actual analysis of the past year. Detailed information is maintained on individual customers - both financial information and non-financial reports. This information is not at the moment held on the computer, but the department has
CASE STUDY - COMPANY E

plans so to do. Information on customers is important, particularly since the Company "targets" specific customers, making the decision each year on which customers to focus in each of the following two years. Among the items considered are: their particular market sector, their potential, the gestation period for the different products and whether the Company specifically wants to sell to a particular customer. Forecasts are set for each product type and the budget is developed on a set mix of products. Since different geographical areas have different sales mix characteristics, a consideration is that if a different geographical area is targeted, a better sales mix might be achieved. The traditional "arms length" relationship between suppliers and customers is seen as being less appropriate in the present business environment than previously, and it is felt that while JIT is to some extent an established technique or mix of techniques, what is of particular interest at the moment is the development and management of the customer/supplier "partnerships" which are emerging. Published accounts are used as a marketing tool, being widely distributed and containing a considerable amount of visual information.

Economic environment and future internal developments

With such a high volume of focused information available there was a general satisfaction with the information currently available, although, as previously mentioned, there are plans to further develop some aspects of the information set, like the cost of quality. The most important board issues reflect the operational and financial aspects of the Company, being market performance, factory performance, profitability and cash position. Of these, the required operational and financial information seemed to be generally available, being internally generated and therefore within the Company's control, but better market information would be useful, this being, however, less easy to obtain. In particular, better
forecasting by customers would be of assistance. Customers are no longer forecasting their requirements so far in advance, causing a problem in this build to order environment. The Company maintains files on competitors, and is reasonably satisfied with the availability of information, but as the major competitors are overseas companies, relevant information on them is more difficult to obtain. Work is also progressing in the related area of the scheduling of production, which will be developed as part of the continuing JIT project. As the organisation of production undergoes a period of rapid change, which may well be of limitless duration, it has become necessary for the Production Director to increasingly stand back from day to day operational issues, and to focus more upon decisions affecting the development of technology, the organisation of production, the layout of the plant, the mix of work, the optimum use of resources and improvements in the technical quality of production and in service levels – the areas in which the Company aims to excel.
CASE STUDY - COMPANY F

Company F is a subsidiary company of a PLC operating in the area of financial services. It employs large numbers of staff, who represent the major element of cost - some 60% of operating costs are staff costs. Because of the financial orientation of the Company's activities, an extremely large and expensive database of information is maintained, but the information base which serves the requirements of customers and complies with legislation is not that which necessarily supports decision making. The Company has increasingly been focusing attention on the problems of gathering more "decision relevant" information, so that product, and therefore overall, profit can be improved. In comparison with the other firms considered in this survey, Company F faces enormous "information" problems, being confronted with the following:

1. an information system which must comply with detailed regulation and is therefore fairly inflexible

2. a huge volume of daily activity

3. a requirement for total accuracy in activity processing

4. an external environment containing huge volumes of information whose reliability is subject to considerable variation

5. the provision of a large number of services, many of which are inter-related in respect of profitability assessment

6. "product lives" which can be quite short, and may at the inception be uncertain

7. an industry whose boundaries are difficult to define, in which both the services provided and the competitors in the market are subject to considerable change.
CASE STUDY - COMPANY F

Objectives

The main objective, which is set at Group level, is the achievement of the profit goal, expressed in absolute £s sterling. This is linked to return on shareholders funds which is also an important goal. Once the Group has set the profit objective, planning at Company level commences. The budgeting system is based on the "top down, bottom up" model in which the Group objective is converted into a series of 'business growth objectives' for each business unit. This is done by line managers, who prepare budgets which are reviewed against objectives set by their superiors. The budgets are then amended as required before being sent back up through the system, summarised by the management accountant, passed through the executive budget committee and finally submitted to the board for approval. The management accounting department is heavily involved in this review procedure, acting in some ways as an intermediary between the Company and the Group. Each Company within the Group is responsible for developing its own budget, within the constraints imposed by the overall strategy set by the Group. At Company level there are few non-financial objectives, since the quantification of intangibles such as quality of service or customer satisfaction was not thought to be possible at present although considerable resources are being applied to market research, and the Company has over recent years doubled the size of the marketing department.

The budget, once set, is fixed for the year, but revised forecasts are prepared every three months to take into account changed circumstances such as capital adequacy (as measured by the regulatory institution). A conventional extensive range of management accounting ratios are produced, these being divided into performance ratios and financial ratios, the latter being concerned with issues such as the risk/asset balance, while the former look at performance, among the cited important ratios being:
CASE STUDY - COMPANY F

expenses to total income
operating profit per £x staff costs
non-interest income/total income

Because the Company operates within the financial services sector, income is derived from both charging customers for services and from earning a margin on the gathering and redeployment of funds. It was felt that a long run objective would be to raise the proportion of total income derived from charging for services, but that any shift in the balance had to take place gradually, and would be difficult to manage. Good quality marketing advice will obviously be a necessity if this transition is to be successfully implemented. The inter relationships between the services provided also presents difficulties in this area, since charging a more visible fee for services provided may lose a potential customer who in the long run might consume a number of the Company's other services.

A monthly report is produced, containing a Profit and Loss Account, Balance Sheet, backup schedules and some pages of analysis. This is passed to the executive management committee and thereafter to the board where a verbal presentation is also given. The information is distributed through the organisation, at an appropriate level of disaggregation, to operations management. Every three months each manager has to write to his line superior to explain any budget/actual differences. The explanation of any such difference may be complex, since many non controllable factors caused by changes in the prevailing levels of interest rates and the actions of competitors vis a vis product launches or withdrawals influence performance.

A unit exists within the Company which produces forecasts of the expected movement in significant variables, such as interest rates, exchange rates, economic growth and consumer credit. Similar forecasts are available on foreign economies, produced by their
CASE STUDY - COMPANY F

domestic financial institutions, and these also are used with discretion.

Performance measures - financial

The performance measures which are used fit in with those expected from a conventional management accounting model. At the level of the Group rather than the Company, the main measures of comparison with competitors are return on capital and growth in earnings per share. As previously reported, profitability, in absolute terms is pursued, rather than say market share. An overall return on capital for the Group is seen to be less subjective than return on capital statistics for the Companies within the Group, since capital for these is allocated on the basis of the capital which the Company should be operating on. This has resulted in a controversial measurement, whose relevance is not universally appreciated.

Only relatively recently has the Group formally organised itself into a number of separate Companies. This organisational change has led to more segmental reporting than before, and has enhanced the impact of decisions concerning the transfer prices which are set in respect of services or funds transferred between Companies. In general such transfers, intra Group, are encouraged, rather than going outside the Group, and the transfers are charged at market rates.

The Company produces for the directors a summary package of financial information comprising series of conventional income/expense and assets/liabilities summaries which "cascade" into greater levels of detail. Most of the statements include details of the prior year comparative figure, the current year variance from budget and the change from the prior year position. The analysis of expenses would thus show:

87
CASE STUDY - COMPANY F

EXPENSES FOR THE NINE MONTHS ENDED......

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>VARIANCE FROM BUDGET</th>
<th>CHANGE FROM PRIOR YEAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>1989</td>
<td>£000</td>
<td>£000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>£000</td>
<td>%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>£000</td>
<td>%</td>
</tr>
</tbody>
</table>

staff expenses:
salaries
overtime...

The Company produces revised forecasts as each year progresses, and adopts the same format for the presentation of the "revised forecast" information, showing the variance from budget and change from the prior year. A reconciliation, in some detail, between the revised forecast of profits for the year and the budget is also presented. The information provision concludes with a series of income statements recording half yearly income and expenses to the level of pre tax profit, and with the % changes in the level of each item between the periods shown:

HALF YEARLY PROFITS BEFORE TAXATION AND EXTRAORDINARY ITEMS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Act/Est 1989</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1988</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2nd half</td>
</tr>
<tr>
<td></td>
<td></td>
<td>£000</td>
</tr>
</tbody>
</table>

Operating income
Net interest
TOTAL INCOME
Staff expenses......
CASE STUDY - COMPANY F

Because the Company provides a number of related services rather than products, the problem of the assessment of profitability becomes increasingly complex, involving decisions which embrace customers, services, transfer prices and a time horizon which may stretch to decades rather than years. Annual (or shorter) reporting periods may therefore not always provide a satisfactory image of the performance of the Company. The Company adopts a marginal costing based analysis of the profitability of different units, looking, for example at the incremental costs and revenues resulting from additional business at the level of the customer, the operating unit and aggregated at the group level. The contribution resulting from additional activity can be extremely high, the cost structure being almost completely fixed, at least in the short term, comprising over 50% of staff costs, the remainder being almost equally split between occupancy costs and operating costs such as printing, stationery and marketing.

Performance measures - non-financial

For a number of reasons, the financial services sector is not renowned for being at the fore in the development of costing or management accounting systems. However, this developmental backwardness is currently under challenge as the focus of management accounting begins to orientate itself towards the information needs of organisations providing services, rather than products, for consumption, and as developments such as activity based costing and strategic management accounting offer techniques which can be equally valid in the context of service costing as in a traditional production environment. The Company at the moment has few non-financial performance measures, but has a commitment to this area with the recently expanded marketing department providing a significant focus in this respect. Although non-financial performance measures are as yet not at an advanced stage of
CASE STUDY - COMPANY F

development, the Company collects and uses a great deal of both financial and non-financial information from its environment. The Company has a department whose function is to provide "economics" information to operating units, some 80% of this information being provided on demand. The information provided is diverse, encompassing predictions of economic indicators such as exchange rate, retail price index and interest rate movements; sectoral studies within both the domestic and overseas contexts; internal consultancy work on privatisations and management buy-outs and input to corporate plans. The Board receive information on market share, the profitability of individual services and special profiles of particular activities, as well as monthly operating statistics and a management accounting review. The Management Accounting Department also uses economics information, the most significant elements being interest rate and exchange rate forecasts, a forecast of economic growth in the economy and a forecast of lending in the economy. Some forecasts are purchased to be subsequently amended before being deemed suitable for use.

The Company has, as previously mentioned, recently devoted significantly more resources to marketing, this department being split into three sections, (1) a personal sector (2) a business sector (3) marketing services, which comprises areas such as research, planning, advertising, merchandising and displays. Management of product and market sectors is being organised on similar lines to a traditional ‘fast moving consumer goods’ marketing approach – a development which represents a major change compared with what had gone before.

The marketing department collects large amounts of information on sales from various sources, mainly internal, as well as buying information on the external market, reflecting the increasing awareness of the importance of the competitive situation. Market research is also commissioned to test the efficiency of advertising.
THE internal information is not held in a manner which enables it to be easily used by marketing. This is a problem of organisational priorities changing more rapidly than can be matched by the information system. The current information set which can be provided is now seen as being based on a biased view of operations i.e., one which provides information concerning services provided, but which currently fails to adequately support the changing and expanding needs of management, which are moving towards focusing upon the customer as a profit centre to whom a range of services is provided, rather than viewing the services as the profit centres, to which a common pool of customers contribute in varying measure. Currently, active consideration is being given to the development of a Group-wide personal customer profitability system. This will allow profitability to be assessed for groups of customers sharing similar characteristics. It is hoped that such a system will help to focus cross-selling efforts into the most profitable areas. A detailed service/account information provision is of course a necessary requirement in a cash based business, and is accompanied by a similar requirement for a large volume of permanent records, from which analysis can pull out trends on account types over a number of years.

Regular reports are produced on the profitability of individual product lines, this information being interpreted in the context of the trend information about the product which comes from the database, and of the market research information which is gathered. A large bi-annual market research survey is commissioned in order to obtain data about market share and service profile. The quality of the market research information, although based on good response rates, is not thought to be as accurate as the Company would like, however, and service profitability analysis is compromised by the problem of overhead allocation which is a major element in product cost.
CASE STUDY - COMPANY F

Competitive analysis is carried out in the area of marketing, but while the service provision/charging structure of competitors' products can be determined, it is not possible to ascertain their cost structures, and therefore their profitabilities. The general assumption made therefore is that cost structures are similar to those of the Company. The non-availability of competitor information is felt particularly strongly with regard to minority services which may be significant in the future. The Company nevertheless subscribes to a market movements service which goes through all the clippings on competitors. The amount of press advertising placed by competitors is also monitored, as are the direct mailshots sent out. On a longer term perspective, information on social trends is gathered, since it can affect areas of the market. There is a desire to develop some form of inter-firm comparison scheme, so that participants can gain a deeper insight into how their performance measures up against that of competitors, by having access to a common pool of hard data. An industry based scheme does exist at present, but the view is that the comparability of the information provided is suspect. Competitor information is reported by way of specific reports on important developments, or by periodic regular reports. The emphasis within this reporting format is gradually changing from the previous preoccupation with financial figures to a broader view which includes market share, monitored monthly in broad areas. Information on new services is monitored in great detail after a launch and in less detail as time passes.

Economic environment and future internal developments

Information falling into this category would generally serve to improve the quality of the market and cost based information provision which is currently available. A number of managers interviewed cited the need for better market share information as an aid to achieving greater profitability, the main goal. The intention
CASE STUDY - COMPANY F

In future is to improve the targeting of services, so that response rates by customers will increase, accompanied by a more economic product marketing effort. In order to achieve this aim, an area/customer analysis has to be undertaken which will create the ability to be able to analyse customers by type of house and neighbourhood. The analysis will rely upon both financial and non-financial data, much of which is already available, but not in a state which lends itself to easy analysis. The targeting of customers has also to be developed so that the correct time to target is indicated.

The financial services market contains a wide range of different participants, providing a considerable variety of narrowly differentiated products, many of which have short lives. In order to gain a competitive advantage, the Company reviews the operations of similar companies overseas, but has found that the issues are similar to those in the UK, and that the business is international. Much of the market research information which is bought is on particular consumer groups, (different consumer groups show a wide range of profitability profiles), albeit that the figures are clouded by the problems of overhead allocation and transfer pricing between services. In future, a more market driven approach to the pricing of services might be adopted, perhaps leading to the withdrawal of services from groups which do not appear to offer profit generating opportunities, either at the time of the review or in the future. In order to make this kind of decision, which would have implications in respect of differential pricing and the cross subsidisation of services, a better understanding than exists at present of the long term relationship between the Company and its customers is required. This would include information which goes beyond, for example, average profitability figures relating to a particular service, and would include a breakdown within the range, giving an indication of which customers cause cost, and are therefore unprofitable. The Company in future may not be able to afford the cross subsidies involved in maintaining a uniform service, provided
CASE STUDY - COMPANY F

at a common cost across a wide range of users with greatly differing service requirements.

The main driving objective of the Company is profit rather than market share. Great attention is therefore paid to trends in profitability, the focus being on long term rather than short term profitability. The Company is trying to better understand and evaluate the causes of long term profitability. One issue is that of determining how to decide how much should be spent on increasing long term profits when many services have a short life span. Efforts are being made to calculate the lifetime value of products sold and of customers - which may be of considerable value. Should such information become available, it would have the potential to make great changes to the way in which sales incentive schemes work, for the marketing of services which produce long term profits but little in the way of short term profit might well be encouraged.

In gathering information on the economy, the Company was critical of aspects of the quality and timeliness of some of the available information. In particular, much of the information was out of date when it was published, Scottish Office data being particularly prone to "untimeliness". An example of the kind of lag which greatly reduces the operational usefulness of the information which eventually emerges was illustrated by the timing of the publication of the 1987 census of employment figures, which was in November 1989. The quality of the index of production figures which are published was thought to be poor, and Balance of Payments data could also usefully be improved. In addition to better information about the operation of the economy as a whole, the Company would like more regional information, since the economies of the different regions experience differential movements.

94
APPENDIX 1

Information Sheet for Interviewees

EXTERNAL REPORTING OF PERFORMANCE MEASURES AND MARKET INFORMATION USED BY TOP MANAGEMENT

A RESEARCH PROJECT SPONSORED BY THE INSTITUTE OF CHARtered ACCOUNTANTS OF SCOTLAND (ICAS) AND CONDUCTED BY JOHN INNES AND JIM MOYES OF THE UNIVERSITY OF EDINBURGH

The 1988 ICAS publication, "Making Corporate Reports Valuable", referred to "the future orientated material which managements employ in planning" and to management's need for "information about important aspects of the economic environment within which the entity operates".

Our research project is to conduct, with the participation of six firms from different environments, a survey into the types of information, both financial and non-financial, which are used in practice by managers. We will be interested in discovering from a small group of managers the decision information which is provided and that which is used. This information will be internal as well as external, and both historical and future orientated. It is important to stress that we are not concerned with actual figures, only with the type of information which is provided and used. Complete confidentiality is also assured and the names of participating firms will not be disclosed.
APPENDIX 1

Following a preliminary interview with each firm we expect to spend a maximum of one hour with a few senior managers or directors from relevant functions such as Finance, Production, Personnel and Marketing and with members of the Accounting Department who are responsible for producing performance or market information. These interviews will take place between October 1989 and April 1990 with some of these interviews being conducted by Jim Bishop, a manager with a large accounting firm.

At the end of the research, a copy of the write up on each firm will be sent to that firm for comment, prior to the survey results in aggregate being submitted to ICAS.
APPENDIX 2

INTERVIEW CHECKLIST - FINANCE DIRECTOR

Introduction

1. Explain project and thanks for participating.

2. Purpose of today’s meeting

   (a) Background on company

   (b) Discuss your main performance reports

   (c) Discuss your information on economic environment

   (d) Select individuals to be interviewed and pencil in tentative convenient dates.

3. Any questions?

A. Background on company

   1. What is the structure of the company?

      (a) Annual Report

      (b) Organisation chart?

      (c) Position of management accounting staff?
APPENDIX 2

2. Have any objectives been set for the company?
   (a) Are these formal or informal?
   (b) How are these objectives set?
   (c) How is their achievement judged?

3. What is the cost structure of the company - approximate %s?

B. Budget and main performance reports

1. Could you describe the main performance measures?
   PROBE - Long-term versus annual?
   - Any non financial measures?

2. Interested in your main performance reports?
   Could we have a specimen copy (without figures)?

3. Who are the major users of these performance reports?

4. Which are the three most important performance measures?
   PROBE - Relative importance of financial and non financial performance measures.

5. Are there any performance measures which you would like to include but the information is not available?
APPENDIX 2

C. Information on economic environment

1. (a) Do you report any information to the Board on:
   (i) specific customers?
   (ii) the market in particular?
   (iii) the economic environment in general?

   (b) If so, what information?

   If not, is this information reported internally?

2. Could we have a specimen copy of these reports (without figures)?

3. What are the three most important pieces of information reported on the economic environment?

4. Do you work with other departments to produce this information?

   If so, which departments?

5. On which sources do you draw for this information?

6. Is there any other information on the economic environment which you would like to report?

D. Other Information

1. Any history or article on company?
APPENDIX 2

2. Approximate number of employees?

3. Do you think that it would be helpful to readers of your financial statements to report any of this information on
   (a) performance measures?
   (b) competitors/market/economic environment?

4. Do you foresee any problems in reporting such information in your financial statements?

E. Selection of interviewees in period October 1989 to March 1990

1. Leave sheet explaining our project which can be given to interviewees if you wish.

2. We should like to interview three or four major users of performance measures and information on economic environment

   (use organisation chart to suggest:
   Marketing Director/Manager
   Personnel Director/Manager
   Production Director/Manager
   Purchasing Director/Manager)
APPENDIX 2

3. We should also like to interview the accountants (or other members of staff) preparing the information on the performance measures or on the economic environment.

(MAXIMUM three)

PROBE - Preparer of information on economic environment.

4. What is the best period for interviews from the company's point of view?

5. (a) Thank for time and assistance.

(b) Tell that some interviews will be conducted by Jim Bishop.

(c) Promise to send a copy of final write-up on the company for any comments.
APPENDIX 3

INTERVIEW CHECKLIST – MANAGERS

1. What contact do you have with the management accounting department

    PROBE – Staff Contact/Meetings

2. Could you provide an outline of the information which the management accounting department provides to you?

    PROBE – How do you use this information?

3. With respect to the information you receive.

(a) Do you find it all comprehensible?

    If NO – what is not comprehensible
    - why do you find it incomprehensible

(b) Does the material provided by the management accounting department contain any information which you already knew?

    If YES – what information?
    - how were you already aware of it?

(c) Is any of the information important to you in your role as (JOB TITLE)?

    If YES – what information?
    - why is it important?

    If NOT – why not?
APPENDIX 3

4. Have any changes been made in the information which the management accounting department supply to you?
   If YES - what changes and reasons?
   - have they improved the information?

5. Would you like to see the information you receive from the management accounting department changed in any way?
   If YES - give details and reasons

6. Have you ever initiated or attempted to initiate changes in the management accounting information you receive?
   If YES - give details and reasons

7. Which are the main performance indicators which you use?
   (a) Does the management accounting department provide information on these performance indicators?
   (b) - If so, in what form?
        - If not, from what source do you receive this information?

PROBE - Long term versus short term

8. Are there any other performance indicators which you would like to use but the information is not available?
   If so, what are these indicators?
APPENDIX 3

9. Please rank in importance your different performance measures.

PROBE - Relative importance of financial and non financial performance measures.

10. What information do you have on

(a) - the market in general?
    - economic environment?

(b) your competitors in particular?

(c) please rank in importance the information on the market and on competitors.

(d) please rank in importance this market and competitor's information against the above performance measures.

11. Do you think that it would be helpful to readers of your company's financial statements (such as shareholders) to report any of this information on

(a) performance measures?

(b) competitors/markets/economic environment

12. Do you foresee any problems in reporting such information in your financial statements?
REFERENCES


REFERENCES


Business Week, 'Annual Reports That Fail', Business Week, October 18, 1976, p. 73.


REFERENCES


REFERENCES


REFERENCES


REFERENCES


MANAGEMENT INFORMATION AND EXTERNAL REPORTING

- six case studies

This book considers the financial and non-financial performance measures used by management and the information held by them on the company's economic environment. It is the first stage of a two-part research project, the second stage of which will determine the usefulness, in an external reporting context, of publishing such performance and market information.

The project originated from the 1988 discussion document "Making Corporate Reports Valuable" (by the Research Committee of The Institute of Chartered Accountants of Scotland) which advocated the removal of the unhelpful division between internal and external reporting which exists at present.

This book will be of particular interest to company managements (and especially to management and financial accountants). It also demonstrates well the way in which research can be used to give a greater insight into practical accounting and management issues.

John Innes and Jim Moyes are lecturers in the Department of Accounting and Business Method at the University of Edinburgh.