CHAPTER 2

CONCEPT OF PERFORMANCE APPRAISAL
OF BUSINESS ORGANIZATION
INTRODUCTION:

Company Appraisal, often called the strength and weakness analysis - a title that correctly reflects what we are looking for, namely, those things about the company which are excellent, advantageous, powerful or beneficial and those which are feeble deleterious or debilitating. We have to be a little careful in trying to categories everything about a company as either its strength or a weakness, because some things may be neither of the two, yet nonetheless important. However, these two categories are useful mental guidelines.

Sometimes this exercise is called the internal appraisal, indicating that the search is limited to strategic factors found inside the company itself as opposed to external factors (considered in the next chapter) over which the company normally has no control, such as government actions and changes in technology.

CONCEPTS OF PERFORMANCE APPRAISAL:

The phrase ‘Performance Appraisal’ is composed of two words, ‘Performance’ and ‘Appraisal’. The word ‘Performance’ means the efforts extended to achieve the targets efficiently and effectively. The dictionary meaning of performance refers to ‘achievement’. "The achievement of target involves the integrated use of human, financial
and natural resources". Performance directly reflects the disposition and utilization of the resources.

Erich L. Kohler referred to performance as "a general term applied to conduct the activities the an organization over a period of time, often with reference to some standard, such as past or projected costs, an efficiency base, management responsibility, or the like."

Appraisal refers to a critical examination with a view to improve performance. It compares the actual performance with targets fixed, identifies causes of significant variations and devises corrective actions. This is naturally turned to assessing whether the business operations would be safe, profitable and appropriate in a given economic situation. Each business enterprise is assessed on its own merits.

The term 'performance appraisal' may be defined as a critical assessment or evaluation of various activities in different areas of operations of an organization. It includes planning as to what should be achieved by an organization, comparing actual performance against what was expected and making a judgment on the quality of that performance, having regard to the actual circumstances under which it was achieved.

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Performance appraisal in its process analyzes the various factors of organization to evaluate the relative strengths and weaknesses so as to meet the opportunities and threat of environment.

Appraisal of a firm is as difficult as appraisal of any individual or family. Like all individuals and families, firms also have different objectives and goals. It would be uncharitable to judge a firm on the basis of the notions of the person carrying out the appraisal, and to declare that person or family to be unsuccessful, etc. Everyone is entitled to be judged by one's own objective. The point of view here, however, is a comparative study of different firms in the same industry or otherwise.

Performance review is the measurement aspect of the method of performing management. It is measurement of the results obtained from the function—the results from the position—and, in conjunction with standards of performance or statements of results required, which is the basic control and learning mechanism of an organized effort. Control comes from comparing accomplishment with plan. Learning comes from observing the results of what we have done, and when the results do not meet requirements, modifying our approach to accomplish better results.¹

A review of the discussions to this point will reveal a series of functions which, if properly appraised and executed, will make for a successful business venture. If management is unable to estimate future events accurately, it cannot assemble and utilize the various factors of business, i.e., men, materials, machines and the like, in their optimum proportions. Somewhere along the line, management is likely to adopt policies that are detrimental to the over-all company goals.

Such error may be due to poor judgment, misinformation, or lack of information. This is to be expected and cannot be completely avoided. There is, however, a limit to the number of mistakes that management can make and still survive in our highly competitive business community.

The management can minimize poor decisions through application of the principles of scientific management to its various problems. In addition, management can improve on its future policies by applying the lessons learned from the evaluation of its past performance. Such evaluation may indicate where company policies have been strong or weak and which individuals or what outsiders influence have been responsible for the turn of events. From this experience, management can strengthen its future-operating plan. This evaluation should encompass each and every segment of the organization. No segment is so unimportant that it precludes examination nor should the performance of any individual be excluded because of the preconceived notion that “the king can do no wrong.” Only through a complete and unbiased appraisal of the management’s activities can the causes for success or failure be established.

In business, as in any other area of activity, success is always a relative concept: relative to other business organizations or relative to some predetermined concept. The implication is that performance may be described as of normal standard, above standard, or below standard, but before performance can be described as standard or otherwise, it is first necessary that a rather specific indication of the

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standard be established. Actually a standard should be established for virtually every area of business activity, like sales, production, and profit to mention a few.¹

Measuring and appraising performance involves several distinct steps. Specific goals or objectives must be established (these are the standards) and there must some means of measuring the extent to which these standards have or have not been met. Analysis of the reasons why goals have not been attained or why they have been exceeded should always follow measurement to provide a better basis for planning future courses of action. Under some instances, goals have been met in spite of rather than because of the wisdom of management. Analysis also provides a basis for the final step in evaluation, i.e., the application of corrective action.²

The direction of management effort should be concentrated on matters requiring their attention, such as operations seriously below the expected performance. Without the application of this principle, effort may be diffused over all operations, showing good and bad performance. "The application of the principle of exception depends on the ability to identify what is significant as compared to what is insignificant. This is a normal feature of accounting practice and is usually a matter of judgment, but statistical techniques are being used to an increasing extent in business problem of this type."³

It is known that in the interest and good health of individual, medical authorities generally advise to have a periodical check up and

examination of his body. Similarly, in the interest if good operating results occur, then every concern should have a periodical appraisal—both diagnostic as well as preventive in nature. In case of an already bad or deteriorating situation it locates the areas and indicates where to make an improvement, whereas in case of good condition, if shows the way to further improve the performance.  

In the appraisal of performance, a broader view is necessary. Performance might be improved by concentrating attention on why a unit has improved on an accepted standard, so that the lessons learned may be applied with advantage to other units rather than directing the efforts to eliminate deviations from the plan. "Checking performance is the third major management activity which the financial planning and control function aims to assist, in particular. It implies the existence of a benchmark against which actual results can be compared."  

Performance of a business enterprise is affected by so many factors, which are inter-related and cannot be satisfactorily examined in isolation. Control systems and the motivation of personnel are key elements in this process.

More formally, a management control system can be defined as a set of policies, procedures and associated information processes designed to help managers to influence organizational activities in the following ways:

(i) by clearly defining objectives and other inputs;


by measuring progress in achieving those objectives;

(iii) by evaluating the enterprise's performance; and by
indicating the means of corrective action.\(^1\)

The control process is represented in figure 1, which helps to illustrate the idea of control as a process incorporating the above four stages.

**Figure 1** The control process


The feedback loop is the flow of information about the level of performance. This information is then evaluated by reference to targets and plans, variations are investigated, and appropriate corrective action is initiated via the control loop.

We often use the words 'efficient' and 'effective' when talking about performance. Having been allocated to particular purposes, the utilization of resources needs to be monitored to ensure that some satisfactory balance is maintained between the actual inputs and the achieved versus the desired outputs. In other words, the efficiency and effectiveness of resource utilization need to be considered.

Efficiency is defined as the measure of the relative amount of resources used in performing a given unit of work. Sometimes characterized as doing things right. It can involve unit costing work measurement (standard time for a task), labour productivity (ratio of outputs to labour inputs), and cycle time.

Also efficiency is defined as the ability to perform a neat operation with a balanced action and controlled supervision. It commonly refers to a ratio of output to input. Thus it can be said that an efficient system is one in which this ratio is optimal. For example, managers are said to be efficient if they produce more and better output with less labour, fewer materials and in a relatively shorter period of time. Thus efficiency implies something "more, better, faster and cheaper." It means looking after and caring for more emergency-room patients in a hospital at a lower cost. It means doubling the number of students taught by a professor. Efficiency denotes the idea of doing well and without waste whatever is being done—whether it is worth doing or not. We are all familiar with people who are extremely efficient in doing something that should not be done in the first place. Someone once said, "There is no point in doing well something that should not be done at all."\(^1\)


\(^{2}\) *Ibid*
Effectiveness is defined as an 'assessment of the qualitative level of achievement of program goals and the intended results, as defined in strategic plans and in legislation'.

Effectiveness has a different connotation from efficiency, as it relates to the achievement of that which one sets out to achieve. It means the accomplishment of a desired objective or outcome. In other words, it tries to answer if the actual results (or outputs) for a given period of time correspond with the desired results. "Effectiveness is concerned with the effect of work on people with the appropriateness of goals, with long-term results, with humanist and idealistic values."\(^1\)

There is always a more effective way of performing work from the viewpoint of recognizing the desire of people to use their intelligence and imagination and to develop their skill and talent fully and fruitfully. Jobs can always be improved so that they may meet human needs in a better way. Organization can be designed to be more congruent with the human personality and with the goals, norms and values of society.

There are four logical outcomes (as shown in figure 2) that take into account rather polarized levels of efficiency and effectiveness. Each 'cell' contains a combination of either positive or negative levels of efficiency and effectiveness. In cell '1', both are positive, which is a happy situation since resources are being used efficiently in producing a desired (i.e. effective) outcome. In sharp contrast, cell '4' contains an extremely unhappy situation, which has connotations of failure. Between these extremes are the greyer pictures of cells 2 and 3: in cell 3 the level of efficiency is good but the degree of effectiveness is poor, and vice-versa in cell 2. Interpretation of these logical possibilities

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depends upon the relative importance attached to efficiency and effectiveness.

![Figure 2 Efficiency versus Effectiveness](image)


"Put simply", as observed by Richard M.S. Wilson and Gerard McHugh "effectiveness refers to doing the right thing, whereas efficiency refers to doing the thing right.""¹

There should be no doubt that effectiveness is much more important than efficiency, even though both qualities are desirable. If this is accepted, it can be seen that cell 2 (effective but inefficient) in the figure is a better place to be in than cell 3 (efficient but ineffective).

An enterprise needs to meet the expectations of its constituent interest groups if it is to be effective. Its survival depends upon this. The more efficiently the enterprise can use its available resources in striving to be effective, the more profitable it is likely to be.

The Advanced Learner's Dictionary of Current English defines effectiveness as "the ability to bring about the result included" or "making a striking impression." Therefore, efficiency refers to performing the job at a least cost while effectiveness refers to performing the right job.

Thus as Erich A. Helfert has rightly pointed out, "The assessment of business performance is more complex and difficult, since it deals with the effectiveness with which capital is employed, the efficiency and profitability of operations and the value and safety of various claims against the business."

CONSIDERATIONS IN ORGANIZATIONAL APPRAISAL:

The purpose of organizational appraisal is to determine the organizational capability in terms of strengths and weaknesses that lie in the different functional areas. This is necessary since the strengths and weaknesses have to be matched with the environmental opportunities and threats for proper strategy formulation. In organizational appraisal, the various forces and influences operating within the internal environment of an organization viz. organizational resource, behaviour, synergistic effects and the distinctive competencies of the organization have to be analyzed. Organizational capability is dependent on these forces and influences. By appraising the organization, the strategists have to develop an assessment of their organizational capability to compete in the markets. There are a number of considerations in organizational appraisal. Which relate to the factors that affect appraisal, the approaches that can be adapted to


appraise them, and the sources of information available to perform the appraisal.

FACTORS AFFECTING ORGANIZATIONAL APPRAISAL:

The factors that affect organizational appraisal relate to the strategist, the organization and to the internal environment. The various characteristics of strategists, as they matter so far as their general management capability is concerned, affect the manner in which organizational appraisal would be done. The nature of organization, the internal environment, its complexity and diversity determine how well the appraisal can be done. To understand how these factors affect organizational appraisal, we consider a few examples.

- The ability of the strategists to comprehend complexity determines how well the different forces and influences operating within the internal environment are analyzed.

- The size of the organization affects the quality of appraisal. Larger organizations are usually more difficult to appraise than smaller ones.

- If the internal environment of an organization is vitiated owing to opposing political forces and power games, the quality of appraisal is likely to suffer. A cohesive management team, on the other hand, is more likely to appraise the organization better.¹

APPROACHES TO ORGANIZATIONAL APPRAISAL:

The approaches adopted for preparing organizational appraisal may range from a highly systematic to an ad hoc one. A systematic approach is adopted as a proactive measure to appraise the

organization and is used when the strategists opt for formal strategic planning systems. An ad hoc approach is generally used as a reactive measure in response to a crisis and occasional organizational studies may be undertaken to determine capability, as and when needed. It is true that not all organizations have a formal or even an ad hoc system to appraise their internal environment. For instance, in smaller organizations, which operate under the entrepreneurial mode, the chief executive may do the appraisal by himself without the aid of formal systems or by conducting ad hoc studies. It is equally true; therefore, that appraisal of organization is an essential prerequisite to strategy formulation.¹

THE SCOPE OF APPRAISAL:

The scopes of the appraisal will necessarily vary from one organization to another, based upon its size and the multiplicity of functions involved. In a small job-order machine shop, where labour costs amount to as much as 75 per cent of total costs, evaluation is quite simple. Success or failure for the organization will undoubtedly hinge on one factor, worker’s productivity. This is true because of the complete reliance on individuals rather than on machines to get things done. In other organizations, appraisal may not be so simple. It is generally agreed that as the number of functions performed in an organization increases, and as the number of individuals having responsibility increases, the problem of appraisal becomes more involved and complex.

The scope of appraisal will also vary in relation to the functions under consideration. A goal should be set for every phase of business


(For details please see Appendix A)
activity. This point has already been established. The goal may relate to sales volume, profit, development of new products, or any other business function. The goal of an enterprise may be stated quite specifically, such as a sales volume of 1 million dollars and a net profit of 5 per cent after tax; or it may be expressed in general terms, such as continued leadership in product research or the development of managerial talents. It must be pointed out that goals cannot always be expressed in specific terms. Because of this, measurement and evaluation of business may be quite general and also in some cases, very specific.

AREAS OF APPRAISAL OF THE FIRM:

The firm has the following important areas of appraisal:

1. Finance

This word covers not only such strictly financial matters as profits and cash flow, but some legal ones too. Let us take the financial ones first. Fluctuating profits can be most debilitating and a serious weakness for some companies operating in industries that are subject to cycles. These cycles are sometimes of long duration (shipbuilding, for example, seems to have a decade or more of upswing followed by decades of decline) and sometimes ridiculously short (for example, umbrellas and fireworks).

High gearing is a weakness and low gearing strength. Sometimes, gearing is so high or so low as to be of strategic importance. Some companies pay very high dividends and some very low. Some companies own property. Sometimes, stock or work-in-progress is an exceptionally high percentage of the capital employed or turnover. In the animal skin industry, for example, stocks...

are frequently 100 per cent of the turnover, because some skins can be bought only once a year. Some companies enjoy special tax concessions and others lease their plant or buy and sell on hire purchase. All these can be of strategic significance.

Now let us turn to the legal aspects. Some companies have peculiar clauses in their articles of association. Others - many others - have gearing limitation clauses in their debenture deeds, some of which may be strategic. Some companies have long term contracts with suppliers, customers or favours. Few enterprises have non-voting shares that must soon be enfranchised. Others are private companies hoping to go public. Many others are already public but have their control still in the founder family's hands. In some, the present controllers are likely to lose control if the company issues new equity, which it badly needs for expansion. Many small quoted companies suffer from low price earnings (P/E) ratios.

Examine the balance sheet. Is the asset backing adequate? How soon can you refund those short-term loans? What has inflation done to your property values? Have you raised any capital in a foreign market and if so, how would an exchange rate shift affect you? How would your imports and exports be affected by such a shift?

The company model is also a useful source of data on financial strengths and weaknesses. It can be asked: how rapidly can we expand the turnover without exceeding our loan capacity? Another vital source of financial data is the examination of the company's past record, where such statistics as a decline in return on capital employed (ROCE), a rise in break-even point, a fall in sales margin, and so on may be revealed. So are the financial and accounting records and the chairman's annual reports for the past five or ten years.
In virtually every case, something of strategic importance will emerge in the finance area. Firstly we should write it up in detail with figures and then boil it down to a few carefully worded sentences that represent a consensus of opinion at the top.

2. Production

This heading includes not only factories, plant, equipment, and machinery, but also offices, warehouses, transport fleets and shop premises - all physical things - as well as all production know-how (production planning, quality control, distribution scheduling, and so on). Consider your company’s factories. How many does it have? Are there too many small uneconomic ones? Are any of them as large as to be dangerously close to the limits of man management or to be dangerously prominent politically? Where are they located? Are they in high cost areas, in high unemployment areas, a long way from railheads or motorways, or in areas of scenic beauty? How modern are they? How old are the machines used, and how up-to-date are the services? How do manning levels when compared with competitors? Is there excessive work-in-progress?¹

You may feel that these items are too insignificant ever to be strategically significant and therefore, that I am breaking one of my own rule, namely, the one about excessive detail. However, I am not suggesting here that the planning team should make a detailed examination of every corner of the company’s production facilities but only that it should examine a corner that may conceal a strategic elephant. All other corners can be ignored. I should add that some of these items are definitely very strategic for some companies; for a company in civil engineering or for a manufacturer of generating sets

for power stations, for example, work-in-progress is decidedly strategic. Every company is different - so different that it is hardly worthwhile attempting to list all the possible areas of strategic importance. Commercial companies, banks, insurance companies, and so on do not have factories, but they do have offices. Are these modern or ancient? Where are they? Who owns them? Is the computer up to standard? The company may be a high street retailer. How many shops does it have? Where are they? Are they too small? Are they in the wrong part of the high street?

I normally also include physical distribution under this heading: warehouses, depots, dockside facilities, transport fleets, ships, aircrafts, and so on. I also include the technical side of production know-how, production planning, stock control, quality control, method study, and material efficiency control, value engineering, workshop layout, process control, safety and health, and so on endlessly.

3. Marketing

It includes marketing, advertising, promotion, customer relations, public relations, selling, distribution, after-sales services, and so on - all the skills are expected under such a heading. However, it also includes customers, products, services, quality, pricing, merchandising, franchising, leasing, packaging, delivery, retailing and product range - absolutely everything related to the company's products and to how, where, to whom they are sold.

Consider first the various marketing skills. In particular consider whether your company has crossed the great division between companies that produce a product and then go out and sell it and companies that find out what customers want and then produce and
sell that. Some anxiety must be felt for those in the former class: they are two or three decades behind the times!

The correct identification of strengths in the marketing area is difficult. Take a company whose share of the market is rapidly increasing rapidly. This may be due to its excellent advertising, its low prices or its strenuous sales force, or it may be due to factors entirely outside the marketing area, such as, the product is superbly well designed or technically advanced or that its competitors have lost their best managers - or almost anything! Since we hope to erect a major new strategy on the strengths that we identify in the company, it is clearly important to identify them correctly. Perhaps, then, marketing is one area where the planning team should especially invite the views of such objective observers as marketing consultants, customers, independent laboratories specializing in product tests, and so forth.

Product comparisons are not normally difficult to make. Remember that this is not a marketing audit but relates to corporate planning, where only major defects or advantages are significant - nor are pricing or quality comparisons. Product range comparisons are more difficult. Go and look at the product range of, say, Fiat, and try to reach a rational conclusion as to whether it is 'better' or 'worse' than other models.

Consider also the various methods of selling: retail outlets, merchants, franchises, leasing, and so on. Which of these do you use? How good at selling are you? If you rely on others to sell for you (merchants or agents, for example), how good are they? Who are your customers? Are there too many of them, or too few? How do they decide to buy your products?

4. Research

Under this heading, we include not only scientific research and technological development (R & D), but much more besides these. Companies have to undertake not only scientific work to develop new products or processes, but also many other kinds of research to develop new services and procedures. A bank about to introduce a new credit card or cash security service, an insurance company about to launch a new type of policy, a retailer about to offer new hire-purchase procedures - all these must be researched in almost the same way as, say, a new product based on laser technology.

In some definition research means all the studies, experiments, tests, designing and discussing - but not the executive actions that have to be done to bring about a change in a company to keep it up to date. To rephrase this into a question: how good is your company at keeping itself up to date in products, processes, materials, procedures, markets and customers?

Here are a few relevant questions related to R&D: Are your products technically advanced? Do your competitors envy your R & D facilities? Can you sell know how, or do you have to buy it from others? Can you actually point to several innovations in your industry emanating from your company's R & D? Do your specialist trade journals often feature your work? One point worthy of attention is that it is useless to state your strength in such general terms as 'Our research team is acknowledged throughout the industry'. It is essential to identify exactly what the team is noted for. Is it for work on the product itself, the process which makes it, the materials used, the new uses found for an existing product, or what?
Now we turn to those other types of research, which include market research, consumer research, motivational research, materials availability studies, and so on. All these activities are devoted to making sure that, when a major decision is taken, it is right - that it is based on a firm footing of fact. One of the major sections to be discussed is 'Management'; when we will be examining the strengths and weaknesses of line executive managers, but here we are discussing the other major constituent of the company's top levels, namely its staff side - specialists, advisers, commentators, experts etc. Some companies employ hardly any of these and rely on entrepreneurial flair.

5. Buying

Buying means procuring, sourcing, and purchasing. In some companies it includes stock control, quality control of purchased goods, receiving facilities, shipping, transport, credit control and chasing. Some of these may well be of strategic significance, but what I have mainly in mind is the purchasing situation itself.

What does your company buy? Make a list of, say, the ten most important components or services or materials. From where do they come? Who supplies them to you? From how many suppliers do you buy each of these materials? Can any of these suppliers deny supplying, or can any event interrupt supplies from them? How big are the suppliers as compared to you? Are you the biggest buyer in the world (or in your nation), or only average or very small? In other words, who has the upper hand: you or your suppliers? Does it matter?

In making your list of key purchases do not forget services, fuels and water, nor any very minor item that, although small in value or quantity, is obtainable from only one remote, esoteric or risky source.
Do not forget all the infinite ways in which supplies can be interrupted, prices distorted or quality reduced: strikes, political (especially tax and duty) decisions, technical advances, nationalism, crop failures, bad weather, earthquake, exchange rate crisis, war, revolution, acquisition of your supplier by one of your competitors, and, finally, depletion of that particular natural resource. Of course, many of these can be reversed to bring good news as well: bumper crops, removal of import duties or taxes. and so on

6. Favours

Under this heading include everyone employed by the company and everything related to them. How many favours are there? Where are they employed? Are they mainly male or female, black or white, skilled or unskilled? Have you measured their productivity in terms of turnover, value added and profits per favour and compared these figures with those of other relevant companies, with the national averages for all companies and with the same figures for the last five years ago?

What about morale? Can you say whether the favours are generally content or discontent? How high is the labour turnover? How often do you have strikes, disputes or accidents? Have you compared these figures with those five years ago, with those of other companies and with the national averages? What about age distribution? What about pay and conditions? Do you really have awful conditions of work (noise, smell, danger) or any really excellent ones (superb research facilities, magnificent computer department), that contribute to poor or good morale?

What about skills? Do you perhaps employ the leading team of oleo-physicists in Western Europe or the largest number of welders? Is
there one man, or a very small team of men, on whom much of the future success of Tile Company rests: a chief designer, perhaps, or a brilliant finance man?

Consider trade unions, of course. Are the unions strong? How many are there? Are there inter-union disputes? Do the unions exploit pay anomalies or anomalies between two or more of your sites? Where do your favours live? Is the local community a close-knit one in which your firm plays a major role?

Finally consider all your favour-related issues: pensions, retirement policies, recruitment, induction, training, promotion, disputes, strikes, participation, work councils, worker-directors, worker-shareholders, pay structures, incentive schemes, and so on. Is there anything here that contains something of strategic significance, either good or bad?¹

7. Management

Under this heading include the managers themselves, their skills and how they all fit together in the organization. There is one key difference between this area and all the others. It is difficult enough for managers to obtain an objective and unbiased view of their company's products, for example, its buying position or its favours, but it is even more difficult for them to obtain such a view of themselves. Although it is better for the managers to make this study themselves than for an outsider to do it for them, there is a strong case for bringing in some outside view at some stage. As a confirmation, or a second opinion, or to adjudicate in cases of disagreement, such a view would be invaluable, and perhaps this is a suitable moment to remind ourselves of the value of those outside-insiders, namely, the non-executive

directors. They often not only have wide experience of industry but know the company intimately as well exactly the sort of view of the company that we need to make in an informed unbiased strength and weakness analysis.

What we need to know is whether the management is capable of handling the company's problems now and over the next few years, just as in the strength and weakness analysis above, we tried to decide whether the company's production facilities, marketing skills and financial situation are adequate or not. As we have seen in countless examples, most companies find such severe weaknesses in one or more areas of their activities that they cannot imagine making a successful onslaught of future problems until these have been put right. Sonic companies, on the contrary, conclude that they can launch an attack on the future with confidence. Plainly, the management's skills are one of the most important areas of all in this analysis, and therefore a vital part of this exercise is often a very personal one; the top half-dozen people discuss their own personal strengths and weaknesses quite openly with their colleagues and even with, or in front of, their subordinates.

There is so little time in these syndicate sessions that no one has a chance to put up an elaborate defensive smokescreen; and if anyone does try to do this, the result is so blatantly biased that his views and those of his syndicate are instantly dismissed, sometimes accompanied by derisive laughter from the other syndicates. So, even in this part of the strength and weakness analysis, where they have to discuss the most sensitive area of all, namely they, the managers can usually achieve valid answers without the aid of an outside view.

However, it can do no harm and may add considerably to confidence if an outsider's view is also sought from among the
company's bankers, legal advisers, and management consultants. This is particularly appropriate in a company run by an autocrat, for in this type of company, it is very difficult for even the top managers to offer any criticism of the autocrat, and it may just tip the scales in favour of an honest and open conclusion if one or more respected outsiders add their voice to the muffled protestations of the favours. Among the features that we need to identify in this management area are: whether there are any great strengths or weaknesses in the lower levels, in the middle levels or at the top of the management hierarchy; and whether the company is particularly good at some special area of management, e.g., production-scheduling, project management, financial control, labour relations, international contract negotiation, etc.

It is often important to look at the age distribution of the management team, succession, training, recruitment from outside and career planning. Discussion of the company's current organizational structure is virtually always relevant, with such questions as whether the company should be divided functionally, geographically or by product groups coming up frequently.¹

8. Position in Industry

Here it is useful to state the company's position as a member of its industry, sector or national economy. Are you, for example, the largest company in your industry or sector, or the largest company in Europe, New Zealand or North town? Where do you rank in size with all the companies that you classify as your competitors? Are you the price leader, the technology leader or the market leader? Do you have any political influence in the United Nations, in Parliament, in Brussels or in North town? Are you so small that none of the more onerous

items of national and international legislation affect you? Can you run rings around the larger competitors?\(^1\)

Appraisal of performance of a company can be done through a careful and critical analysis of the financial statements. Financial analysis helps managers in controlling their enterprise performance. It does this by providing them with a system and set of procedures for analyzing and understanding financial indicators of performance. The two important financial statements are the 'balance sheet' and the 'profit and loss account'. Although any formal statement expressed in money value might be thought of as financial statement, the term has come to be limited by most accounting and business writers to mean the 'balance sheet' and the 'profit and loss account'.\(^2\)

**PERFORMANCE APPRAISAL THROUGH FINANCIAL STATEMENT ANALYSIS:**

Financial Statements indicate the operating results and financial position of a concern; therefore, by analyzing and interpreting these statements, performance can be appraised. For this purpose, analysis of financial statements is made. Financial statement analysis is a preliminary step towards the final evaluation of the results drawn by the analyst or management accountant. Appraisal or evaluation of such results is made thereafter by management. Financial statement analysis is the process of scientifically making a proper, critical and comparative evaluation of the profitability and financial position of the concern. "The appraisal or analysis of financial statements spotlights the significant facts and relationships concerning management

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performance, corporate efficiency, financial strength and weakness and creditworthiness, which would have otherwise been buried in a maze of details. According to Metoalf and Titard, "Analysis of financial statements is a process of evaluating relationship between component parts of financial statement to obtain a better understanding of a firm's position and performance."

Evidently, performance appraisal is the end of a continuous accounting cycle, which starts with the classification, recording, summarizing, presentation, and analysis of data and ends with the interpretation of results obtained from critical analysis thereof.

**PROCESS OF PERFORMANCE APPRAISAL:**

The financial statements contain all the data relating to operating results and financial position of the business. Besides this, other documents such as reports, schedules and explanatory notes are also appended. Overall performance of the business is appraised by analyzing these statements; hence, the process of financial statement analysis is the key process of performance appraisal. The process of performance appraisal through financial statement analysis, is summarized below:

1. Some logical arrangement of financial data in an orderly sequence is made in a condensed form. The balance sheet and profit and loss account figures are rearranged to facilitate performance appraisal.

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2. Figures are approximated to the nearest thousand to simplify the process of appraisal.

3. The appraisal of performance is designed to make a careful study of past financial records in the light of economics already experienced so as to make an orderly attempt to make an informed guess as to the future probabilities.

4. The analyst should utilize his knowledge of financial statements to draw up performance appraisal programme, which must be tailored to fit in the specific needs.

5. Performance appraisal may be conducted either internally or externally. Those who are within the enterprise and have access to detailed records come under the purview of internal appraisal. Management generally conducts such appraisal for their purposes. External appraisal on the other hand, is conducted by those or for those who are outside a business enterprise such as shareholders, creditors, bankers, trade unions, government agencies and research scholars.

**AREAS OF PERFORMANCE APPRAISAL:**

The measurement of progress and the appraisal of performance are closely related. The performance measurement is concerned with the efficiency and effectiveness of converting inputs into outputs. It has already been discussed that performance appraisal should be understood as a part of the control process. Performance measures should be chosen which provide useful information for the control system of management. Therefore, a measure should tell us something about the level of achievement of goals or targets. The important areas of performance appraisal are discussed below:
1. **Profit and Profitability**: The existence of a business enterprise wholly depends on its ability to earn profit, which is considered as the most important criterion of the enterprise's performance. It is applied universally in absolute form as well as in its relative form. Profitability indicates the efficiency or the performance of an enterprise and shows how the enterprise is utilizing its resources. Various profitability ratios are calculated for appraising the performance of a business.

2. **Sales Trends**: The figure of sales is an index of progress made by a company. It can also be used as an indicator of managerial efficiency. Marketing of the product is also one of the most important areas of operation. In the process of performance appraisal, sales indices are computed and compared with that of other similar companies, for arriving at an objective conclusion. Computed trend values of sales may also be derived by applying linear least square method and then performance of the company may be measured by comparing the actual sales with the computed sales.

3. **Production**: Production is one of the most important areas of performance. The indices of production by the company may give an idea as to how the company has performed in the year under review as compared to the past or how the company has performed as compared to other companies. Production performance of a company can also be measured by analyzing capacity utilization. The production of a concern can be compared for different years with that of the companies in the same industry and with the industry as a whole of which the company is a part.

4. **Funds Management**: Performance of the resources or funds invested in the business can be appraised by fund flow analysis. This criterion shows the funds used in the business and sources of funds or funds received in the business. Performance of a company will be
better if effective system of management of funds is operating. In this measure of performance, a statement of changes in working capital is also prepared. This also helps in judging the effectiveness of working capital management of a company. Funds flow statement is prepared to analyze the funds position in a business enterprise.

5. Financial Strength: Appraising the financial position of a business also does effect Performance appraisal. The financial position or the financial strength shows whether a business is being operated on sound financial basis or not. Owners, creditors and lenders of a company are interested in the financial strength. It is also an important criterion of measuring performance. In this area of performance appraisal, short-term financial strength and long-term financial strength is measured by calculating various ratios.

6. Value Added: An enterprise may exist without making profits but it cannot survive without adding value. Value added measures economic value created; it can be used as a measure of productivity. Value added indicates the wealth created by a business with the application of labour and Capital. Various ratios related to value added are computed for appraising the performance.

TECHNIQUES OF PERFORMANCE APPRAISAL:

Performance appraisal through financial statements consists of a study of relationship and trends to determine whether the financial position and results of operations and overall progress of a company are satisfactory. The techniques of performance appraisal are frequently applied to the study of accounting data with a view to determine the continuity or discontinuity of the operating policies, investment value of business, credit ratings and testing the efficiency of operations. The techniques of performance appraisal are developing
fast and have acquired a scientific temper. The various important techniques, which are used for performance appraisal, have been summarized below:

1. Ratio Analysis: The modern technique of performance appraisal is the ratio analysis technique. It is the principal and universally accepted technique of assessing the operational efficiency of a business enterprise. Often a ratio is known as a symptom like the blood pressure, the pulse or the temperature of a person. The analyst can X-ray by its use the financial growth and development and the present condition of the business enterprise. "Ratio Analysis", in the words of Erich A. Helfert, "provides, guides and clues especially in spotting trends towards better or poorer performance and in finding significant deviations from any average or relatively applicable standards."^1 According to J. Batty, "The term accounting ratio is used to describe significant relationship which exists between figures shown in balance sheet, profit and loss account, budgetary control system or in any other part of the accounting organization."^2 Hence, ratio analysis is an effective instrument which, when properly used, is useful in assessing the objective of business, achieved by it. As a measure of efficiency it is the main tool of making intra-firm and inter-firm comparisons. Under this technique of appraisal, various ratios are calculated, the classification of these ratios may be as follows:

(i) Liquidity Ratios: Liquidity ratios are designed to measure the ability of a company to meet its short-term obligations and to reflect the short-term financial strength. The two commonly

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used liquidity ratios are (a) Current Ratio, and (b) Quick Ratio.

(ii) Leverage Ratios: These ratios help to measure the financial contribution of the owners compared with that of creditors as also the risk of debt financing. These are also known as capital structure ratios. The leverage ratios are (a) Debt -Equity Ratio (b) Fixed Assets to Net Worth Ratio (c) Interest Coverage Ratio, and (d) Gearing Ratios.

(iii) Activity Ratios: Activity ratios are also known as turnover ratios. These ratios enable the measurement of the effectiveness of the usage of the resources of a concern. Activity ratios are (a) Fixed Assets Turnover Ratio, (b) Turnover Ratio, (c) Stock Turnover Ratio, (d) Current Assets Turnover Ratio etc.

(iv) Profitability Ratios: "A measure of profitability is the overall measure of efficiency". Furthermore, the purpose of profitability measurement is to see whether an enterprise has effectively used its resources to achieve its profitability objective. "These ratios are intended to measure the end-result of business operations." The various ratios included in this category are: (a) Gross Profit Ratio, (b) Net Profit Ratio, (c) Return on Capital Employed Ratio, (d) Operating Ratio, (e) Net Profit to Net Worth Ratio, (f) Price Earning Ratio, (g) Dividend Yield Ratio, (h) Earning per Share.

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2. **Trend Analysis**: Comparing the past data over a period of time with a base year is called trend analysis. Trend analysis makes it easy to understand the changes in an item or in a group of items over a period of time and to draw conclusions regarding the changes in data. Under this method, percentage relationship that each item bears to the same item in the base year is calculated. It is a dynamic method of analyzing the changes over a period of time. The analyst compares the trend of related financial and operating data in forming an opinion as to whether favourable or adverse tendencies are reflected by the data. This technique of appraising performance indicates the direction in which a concern is going and on this basis forecast for the future can be made.

3. **Common-size Statement Analysis**: In common-size financial statement analysis method, items reported in the financial statements are converted into percentage, taking some common-base. In the Common-size Income Statement the net sales are assumed to be 100% and other items are expressed as a percentage of sales. Similarly, in the common-size balance sheet, the total assets or total liabilities are taken equal to 100 and all other items are expressed as a percentage of this total. These statements are also called 'Component Percentage Statement' or "100 per cent Statement". This technique of performance appraisal is also very useful in inter-company comparison, as it becomes easier to know the performance on the basis of the percentage of the figures, revealed by the financial statements of the company.

4. **Fund Flow Analysis**: Fund flow analysis technique is an efficient technique for the management to assess the growth of the company and its resulting financial needs, and to determine the best way to finance those needs. It provides answers to many questions, which are very important from the point of view of
performance appraisal and management control. Fund flow statement reflects the sources of funds invested in the business and the application of funds. It indicates change in items of financial position between two different balance sheet dates. Fund flow statement is also known as 'Sources and Uses of Funds Statement', 'Where Got and Where Gone Statement' etc. In addition to the fund flow statement, a 'statement showing changes in working capital' is also prepared for this purpose.

5. Other Techniques: There are various other techniques, which can also be used for appraising the performance of a business. These techniques are as follows:

(a) Cash Flow Analysis Technique,

(b) Break-Even-Analysis Technique,

(c) Statistical Techniques - Such as Average, Range, Index Number, Standard Deviation, Correlation, Regression and Analysis of Time Series.

(d) Diagrammatic and Graphic Presentation of Data.

These techniques of performance appraisal provide a scientific, systematic and objective assessment of the efficiency and effectiveness of the operations and financial and overall health of a business enterprise.

LIMITATIONS OF PERFORMANCE APPRAISAL:

Performance is a relative term. It can be judged by comparing the data of different companies or industries or of the same company for different years. Since business conditions vary much from company
to company and from industry to industry, no attempt to assess business performance can provide firm results. Differences exist in location, products and services, capital structure, plant capacity, accounting policies, level of efficiency, caliber of management, to name but a few. Further, complications have been added by the advent of multi-product and multi-business companies. On account of these differences, performance appraisal of a business becomes a very difficult task for an analyst. Therefore, while appraising the performance of a business the analyst should keep the above mentioned differences in mind.

Moreover, the performance appraisal of a business enterprise through financial statement analysis is based on financial data obtained from financial statements. Since, financial statements have a number of limitations; performance appraisal is also adversely affected by some of the limitations. The important limitations of performance appraisal may be summarized as under:

(1) Interim Reports: Financial Statements of a company are essentially interim reports usually prepared for an accounting period. Hence, the financial information as revealed by them is neither complete nor exact. The true information can be known only when the business is closed down.

(2) Historical Data: Performance of a business enterprise is appraised on the basis of historical data revealed in financial statements; as they do not reflect price-level changes, so appraisal of performance is of little value in decision making.

(3) Quantitative and Monetary Data: Performance of a business should be appraised keeping in view both quantitative and qualitative information but financial statements depict only those items of
quantitative nature's which are expressed in monetary terms. A number of qualitative factors such as efficiency of workers, reputation and prestige of management, customers' satisfaction, loyalty and integrity of management and favours are not depicted by financial statement. Without taking into consideration these factors which are essential to assess the performance of a business, performance cannot be appraised correctly.

(4) Unrealistic Accounting Concepts and Conventions: Financial statements are based on accounting concepts and conventions, which make them unrealistic. For example, the value of fixed assets in the balance sheet are shown on the basis of 'going concern concepts'. This means that value put on an asset rarely represents the amount of cash which would be realized on liquidation. Similarly, the income statement, which is prepared on the basis of the convention of conservatism, fails to disclose the true income, for it includes probable losses and ignores probable incomes. Thus, performance appraisal can not give true and fair picture of a business.

(5) Personal Judgment: Personal Judgments influence financial statements, which in turn affect the performance. Many items such as inventory valuation, method of depreciation, etc. depend on the personal judgment of the accountant, which depends on the skill, integrity, and competence of the accountant.

"The success of an investment depends ultimately upon future development, and the future may never be analyzed with accuracy. But if you have precise information as to the company's present financial
position and its past earning records, you are better equipped to gauge its future possibilities.\(^1\)

While appraising the business performance, the analyst must keep it in mind that he is assessing the past performance by using historical data and yet he has to give his estimates and suggestions about the future. Erich A. Helfert very rightly said, "The analyst must further realize that an assessment of performance deals with past data and conditions, from which it may be difficult to extrapolate future expectations. Yet, it is the future that can be affected by the decision-the past is gone and can not be changed."\(^2\) However, performance appraisal can not give an absolute answer to every question of doubt, but it can point put the direction in which future enquiries should be made. In this context the next chapter deals with Charoan Pokphand Feedmill Co., Ltd. (CPF) : An Appraisal of organization and working.

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2 Erich A. Helfert, Op. cit, p.34.