**FINANCIAL PERFORMANCE MEASURES IN THE PRIVATE SECTOR**

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**SHORT AND LONGTERM FINANCIAL PERFORMANCE**

Short term financial performance measures are used for:

* Control purposes, e.g. variance analysis are carried out comparing actual and budgeted results and investigating any differences.
* Determining executive rewards – rewards may be linked to the achievement of short term targets.
* Assessing the quality of past decisions and assessing the impact of decisions yet to be made.

**PROBLEMS OF USING SHORTTERM TARGETS TO APPRAISE PERFORMANCE**

A focus on short term performance (and the measurement of manager’s performance on short term results) can threaten a company’s ability to create long term value for its shareholders. Managers may feel the pressure to achieve short term targets (such as a target ROCE or gross profit margin) and, as a result, long term performance may be compromised. For example:

* Investment in new assets is cut. This may lead to a short term boost in profits but long term profitability may suffer as a result of old, and potentially inefficient, assets being used.
* The development and training budget may be cut to boost short term profitability. However, employees are now a key resource for many organisations and a lack of investment in this area could lead to a loss of competitive advantage and a resultant fall in long term profits.

**STEPS TO REDUCE SHORT TERMISM**

* Use financial and nonfinancial measures: these should focus manager's attention on long term financial performance. Methods such as the balanced scorecard can be used
* Switch from a budgetconstrained style: a switch should be made to a profit conscious or no accounting style (Hopwood). Both of these approaches have a more long term focus.
* Share options: if these are given to management they should focus their attention on improving share price and hence long term performance.
* Bonuses: these should be linked to profits over timescales greater than one year.
* NPV and IRR: should be used to appraise investments. Discounted cash flow techniques recognise the future economic benefits of current investments.
* Reduce decentralisation: this should increase central control and reduce the problem of dysfunctional behaviour.
* Value based techniques: focus on the key drivers of shareholder wealth

**SHOULD A SHORTTERM APPROACH EVER BE TAKEN?**

It is generally accepted that a focus on long term performance is superior. However, there are some situations when it is important to measure the achievement of short term targets and to link rewards to these targets.The best example of this would be an organisation which is fighting to survive. It is only by overcoming short term hurdles and building short term profits that long term survival (and profitability) can be achieved. Cash flow measures may be more important than profit measures at this stage.