MEASURING PERFORMANCE, VALUE CREATION AND VALUE-BASED MANAGEMENT IN THE CONTEXT OF COMPETITIVENESS AND GLOBALIZATION

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Abstract: In times of uncertainty, knowing the best methods of measuring performance and creating value, determines the increase competitiveness of companies. By development of international markets and globalization, companies pursue entry in many national, regional or international markets. Competitiveness of companies is linked to performance; the latter can be presented by various methods, as this company must have a sustainable presence on the market. Performance and value creation concepts are common in company reports, but most often these concepts are not defined. Through this study, we highlight their importance and we measure this direct link between past performance and future value creation.

JEL classification: G39, M21

Key words: performance; value creation; value-based management; competitiveness.

1. INTRODUCTION

In the current economic context, the proper use of economic concepts, is a simple way to avoid errors. Frequent use of concepts of economic and financial performance, and value creation has led to the development of research on these concepts and high interest from the financial community. International bankruptcies increased the need for detailed knowledge of economic concepts in order to avoid conceptual error. Moreover, these failures have called into question how best to measure performance. It is a challenge for company management and financial analysts to find the best way to measure performance related to industry and company profile. This constant preoccupation, leads to the initiation mechanisms of competitiveness. Competitiveness means efficiency and future development, a necessary business purpose. However, studies lead to the conclusion that there isn’t a unique indicator of performance measurement; perceived performance is different, considering internal and external factors.

A common criterion for measuring performance since the 90s is to value creation. Starting from value creation, a series of economic indicators was developed for measurement: the economic value added (EVA), market value added (MVA), total shareholders return (TSR), cash-flow return on investment (CFROI), return on capital employed (ROCE), cost of capital (WACC). In practice, companies choose the indicator that shows the most interest for the company's needs.

This choice is based on the manager's role to create value for shareholders. Outlining the concept of value-based management means orientation of all processes and systems in a company to create value. Based on these assumptions, we will present our view on economic performance and value creation, presenting the relationship between these two concepts, and methods of implementation within a company through value-based management.

2. LITERATURE REVIEW

Throughout time, several authors have analyzed the economic and financial performance, value creation and value-based management. Financial performance has been assessed through the approach of measuring instruments [4], having an important role in knowledge and understanding of the concept. Moreover, various authors have followed the assessing financial performance by the methods of valuation, presentation and analysis [2], through a comprehensive study on the concept.

Value-Based Management is presented in terms of different views on the role of management in a company [1]. On one hand it may be that shareholders are owners of business and management is obligated to represent their interests through maximizing the value of shares. On the other hand, we believe that management is mandated by the shareholders to ensure long term continuity of business. We believe that the two approaches may be interposed by the role management to create future value for the company along with long-term sustainability of the company**.**

3. ECONOMIC PERFORMANCE IN THE CONTEXT OF GLOBALIZATION

The term of performance has become extremely popular in recent years in a wide range of activities such as arts, literature and social sciences. As the popularity and use of the word increased, as well as the research about performance have multiplied, trying to analyze and understand what kind of activity is this. In this sense, we are interested in those aspects related to the concept of performance overall, and particularly in the economic field.

In common language, performance signifies excellence in a particular area, by recognizing trends and results in a given time. Performance can be seen in terms of three key moments:

-When recognizing the results achieved as effects of past and completed actions. Thus based on the evaluation and comparison of the actions, we can consider the result of a particular domain. This moment is most common in describing overall performance and in particular the economic way.

-Continuous success in a given field. This moment can turn in past performance, as a result of influence of negative events or decisions. In the economic field, the management is responsible for ensuring the sustainability of economic performance through indicators known as the benchmark for performance measurement.

-Actions taken now to achieve future performance. Companies are concerned with the development of strategic goals through planning, design and implementation will lead to future performance.

“Performance is an unstable level of potentiality of an enterprise, carried out by optimizing value-cost link and that made the company to be competitive on strategic segments.” [5] In the acceptance of the authors competitiveness is the manner of expression, and a competitive enterprise is an effective and efficient enterprise. More "performance is a state of competitiveness of the company reached through the level of efficiency and productivity that provides a sustainable market presence." [5]

Over time, an enterprise performance evaluation was a topic debated by theorists and practitioners, in an attempt to find the best measuring tool. Thus among the performance indicators used in the 60s and 70s, we can find the company size and turnover evidenced by total assets. This method was not expressing a firm performance, especially with economic inefficiency of large enterprises. Industrial development led to the use of accounting profitability with net profit, earnings per share and PER. Profit is the difference remaining after covering all expenses in the enterprise. As a basis for payment of taxes, there were adopted a number of national and international regulations to calculate profit. Among its limitations include the possibility of manipulating the outcome through various accounting treatments in order to reduce the final basis for calculating tax payable by an enterprise. So profit is not fully express company’s performance at a time.

Since the 90s a number of indicators reflecting the value creation process have been created to support companies such as: economic value added (EVA), market value added (MVA), return on capital invested (ROCE) added value to customers (CVA).

These indicators were successful on large American corporations that have addressed this method for measuring performance.

Yet these indicators have a number of limitations. The economic value added (EVA) is a calculated based on financial accounting methods for achieving revenue and expenditure recognition. If managers are rewarded based on the high level of EVA in a certain period, they can manipulate results to achieve the desired result.

Thus we will present three examples commonly used for handling EVA.

- Managers can manipulate revenues recognized over time by selecting the delayed and accepted orders. Thus, high-value orders may be accepted and forwarded to the accounting period to end customers before the deadline for delivery, while less profitable orders may be delayed and submitted after the closing period. The result is an increase of EVA, but an unfair relationship of current and potential customers.

-Costs can be reduced to increase EVA. For example, an employee training program conducted by a specialized company may be terminated before completion of the accounting year. Savings realized by the company will reduce training costs for the period, and will increase EVA. In this case the relationship with employees will be affected.

-Managers can decide not to replace fully depreciated assets. Keeping depreciated equipments, will reduce the value of assets, and will make depreciation expense not to be recognized, leading to increasing EVA. In the situation the quality and customer satisfaction will suffer if these equipments will be used in the next period.

Given the potential problems that can occur, nowadays another performance criterion is needed, namely "creating value, subordinate the desire for sustainable development" [4].

4. VALUE-BASED MANAGEMENT – METHODS OF APPLYING THE CONCEPT OF VALUE CREATION

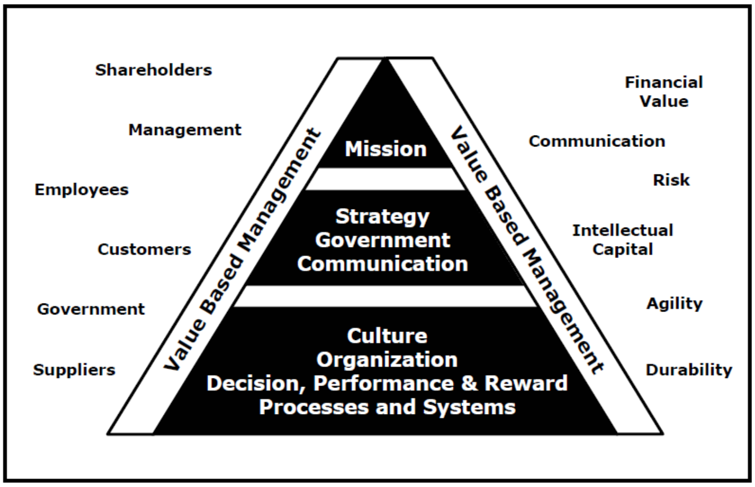
Value-Based Management is a company's management approach to value creation, particularly by maximizing shareholder value. In the context of competitiveness and increasing demands on performance, value creation should be subordinated to sustainable development as a bridge to the community, customers and employees.

Value-Based Management includes:

- Creating Value (ways to maximize growth and future value). This includes defining strategies for companies both short and long term.
- Managing by value (governance, change management, organizational culture, communication, leadership)
- Measuring value (assessment)

These elements are very well outlined steps in the company's objectives and especially in the management of the company. Management's planned strategies can have a major impact on future actions of stakeholders, so that management should take into account their interests in parallel with the interests of stakeholders.

Items included in the value-based management are presented in Figure 1.

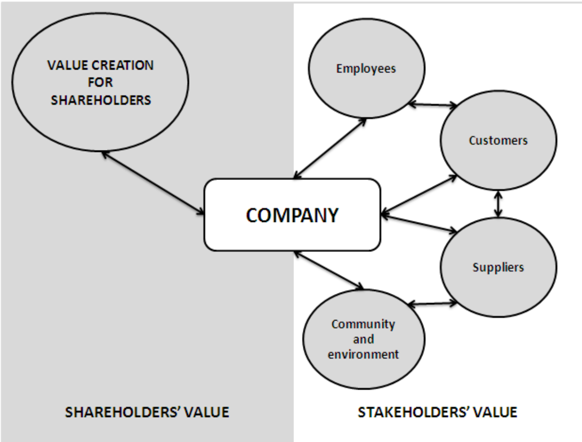


Source: www.valuebasedmanagent.net

Figure no. 1 Items included in Value-Based Management

Value-Based Management depends on corporate objectives and company values. Economic objectives can be either economic (shareholders value) and may also cover the other parts (stakeholders value). The vision of the shareholders' value over the value of stakeholders' value is discussed in the economic environment for a long time, concentrating to find the best options that a company should be centered to both perspectives. In market economies, there is an agreed idea that a company must follow economic profitability. Moreover, companies must search for a high level of social responsibility for their future development. Most times, profitability and responsibility are contradictory, resulting in management decisions directed toward one of the two concepts.

On the one hand, companies must be profitable to survive and big companies need to remunerate capital at a rate of return that exceeds its cost. This rate of return should be higher than the interest obtained in the case of a bank deposit in order for business development to be justified. Improve profitability, and consequently a higher income leads to increasing investor confidence, reflected by increasing the stock's price, which makes it easier to achieve long-term business goals. Such profits are not just results, but a source for future competitiveness and prosperity.



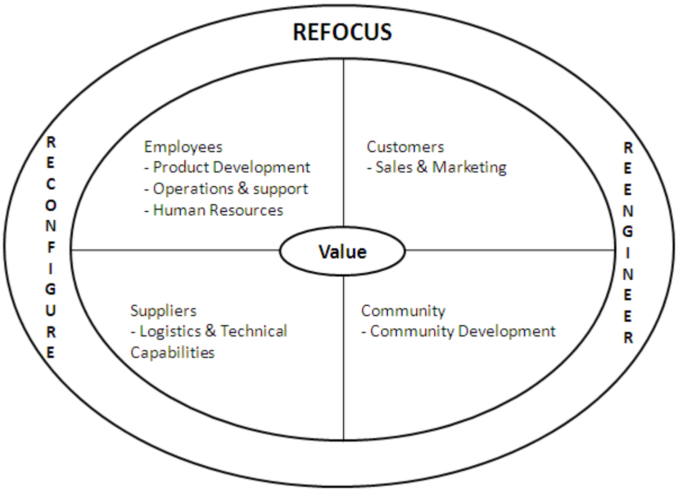
Source: J.M. Stern, J.S. Shiely and I. Ross, "The EVA challenge- implementing value-added change in an organization", Wiley Publishing, 2001

Figure no. 2 The relationship between the company, shareholders and stakeholders

On the other hand, companies are organizations where people work together. By developing technologies and services, employees represent now most of the company's value (intellectual capital). To motivate employees to work more closely to company interests, a level of trust must be built with them. Same level of trust needs to be developed with the external environment with which the company interacts. Thus the company get daily in contact customer, for whom it must design loyalty programs to keep old customers, and promotions to attract new clients. A direct relationship and based on the confidence of suppliers is a strength in business development. Starting from timely receipt of orders and payment methods, relationship with suppliers can make a difference in a competitive economy, influenced by globalization. Finally, the company must follow closely the relationship with other categories of stakeholders (government, community and environment), so direct connection between the company and related parties will lead to increasing profitability.

The link between corporate performance, value for shareholders and stakeholders may be synthesized by Figure 2. We propose a model for tracking the company's performance taking into account the various categories of stakeholders.

Throughout time there have been several models developed in connection with value creation as a means of communication and efficiency of employees' activity of others categories of stakeholders. Such a model for leadership through the creation of value made by Briggs & Stratton, is shown in Figure 3 [3].



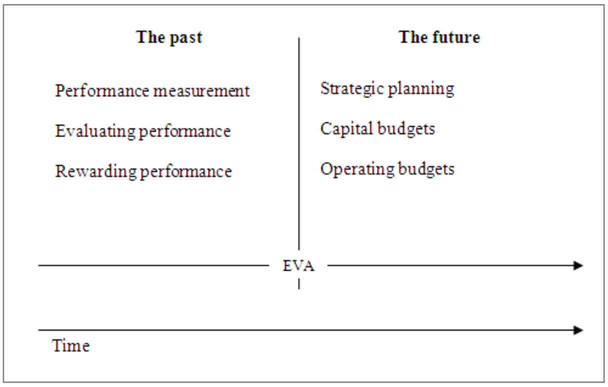
Source: J.M. Stern, J.S. Shiely and I. Ross, "The EVA chalenge- implementing value-added change in an organization", Wiley Publishing, 2001

Figure no. 3. Briggs & Stratton model: Managing for value creation

For creating the maximum possible value for shareholders, a company management must be committed to creating value in relation with customers, suppliers, employees and communities [3]. The model shows the most important functions. Regarding the importance of these functions presented by Briggs & Stratton model, we emphasize the integration of employees in value creation process. Actions of employees are oriented to product development in parallel with an interest in human resource development. Considering the concept of intellectual capital development, we can say that employees are a vital resource for the company, especially in difficult times. Although many companies this category is neglected, human resource development can have the greatest potential for adding value hidden and unexplored. Company management challenge is to provide an environment where employees regain their interest in the ability to create value. The model shows the relationship with customers through whom to draw value, the company must follow the process of sale and marketing. To develop and initiate new relationships with suppliers in an increasingly competitive market, it needs to develop technical and logistical potential. Last but not least the community development where the company operates is a necessity today.

5. CONCLUSIONS

To achieve responsibilities, company managers evaluate subordinates' performance through planned objectives for value creation. Moreover, shareholders follow the evolution of the overall company value using different methods of measurement. Thus, companies are looking for performance measurement methods to be used by executives and to ensure that the direction of the company is for value creation. These performance measurement tools can be used to compensate high performance (through bonuses or promotions), but can be used as a basis for decisions on lack of performance. Performance measurement action is by definition based on historical data. It evaluates and compensates the company's management on the basis of what has been achieved in finished period, and not on future expectation. The issue of historical link between performance assessment and future direction for value creation arises. Thus the company's shareholders may be tempted to wonder if management is sufficiently motivated to create value for them and to take necessary decisions to avoid investments that destroy company value.



Source: S. D. Young, S.F. O'Byrne, "EVA and Value-Based Management – a practical guide to implementation", McGraw-Hill Publishing, 2000

Figure no. 4. The link between evaluation and performance measurement

This connection is made through value-based management and economic value added indicator. The relation is presented by Figure 4. Throughout EVA, there can be achieved both future assessments, and measuring performance, in order to create a good benchmark for management compensation. One of the strengths of EVA is that it provides a direct link between performance measurement and evaluation of a company, providing support that management performance is assessed and paid in conjunction with long-term objectives of the company. Yet considering the possible limitations of EVA implementation, the management must take into account the desire for sustainable development, seeking each category: employees, customers, suppliers, community that may lead to maximizing the value created in parallel to increase long-term company performance.

6. ACKNOWLEDGEMENTS

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