The use and consequences of performance management and control systems: a study of a professional services firm

Research executive summary series
Volume 6 | Issue 10
**Key findings:**

- Targets are a useful means to motivate and assess the performance of employees in the organisation; however an excessive focus on targets, both financial and non-financial in the organisation’s performance evaluations may have a de-motivational impact on employee behaviour.

- The superiors were found to be important factors in mitigating the negative impact of targets on employee behaviour caused by a heavy emphasis on targets in performance appraisal.

- If targets are perceived to be unreachable, this results in undesirable behaviour (for example, taking undesirable actions to meet budget targets).
Introduction

This research executive summary outlines results from a case study of employees at a regional branch in a large UK accounting firm on the use and consequences of performance management and control systems. The main study results are reported in Ururuka (2007) and Ururuka et al. (2009). The survey enquired about employee perceptions about the types of targets used, how they were used in performance assessment and the behavioural consequences of these targets at different hierarchical levels. Our results show that the excessive reliance on meeting targets in performance appraisal is inextricably linked to dysfunctional employee behaviour. Despite recent suggestions from advocates of the Balanced Scorecard that non-financial targets would prevent adverse effects of target use, we find comparative results of the harmful side effects of target use, irrespective of whether financial or non-financial targets are used in performance evaluation. We do however find evidence that the negative impacts of targets in performance assessment may be overcome through more frequent interaction between managers and junior employees.

Overview of project

Objectives of the research

Targets are of vital importance in organisations since they potentially provide a useful motivational tool for managers and offer a means of performance assessment. Until recently the focus on target use has been on financial targets. However, since the introduction of the Balanced Scorecard, there has been much discussion of the merits of using non-financial targets in performance evaluation systems. In this study, we examine what types of targets are used (i.e. whether they were predominantly financial or non-financial) and how they are used in the organisation. We also seek to identify any differences in targets used at different hierarchical levels. The key research questions to be answered were:

- What is the nature of performance targets used in the organisation (i.e. financial or non-financial)?
- How is performance evaluated against these targets?
- Does target use and performance assessment differ by organisational hierarchical level?

Why study an accounting firm?

Our study uses a case study approach, focusing on an accounting firm. Accounting firms emphasise the use of targets in their everyday work and are very hierarchical in structure. In addition accounting firms pose considerable control problems from the senior manager’s point of view:

- **Accounting firms are characterised by high staff turnover.** After becoming professionally qualified, many employees seek to leave the organisation. Given the ‘up and out’ culture of accounting firms, motivation and work quality could be adversely affected if employees have already decided to leave the organisation in the near future.

- **Monitoring the due diligence of junior staff in audit tasks is difficult.** Managers’ attention therefore tends to be based upon time taken to complete tasks (Kelley and Margheim, 1990; Otley and Piece, 1996a and Pierce and Sweeney, 2004). Time budgets are therefore crucial in an accounting firm and tightness of such budgets inevitably leads to undesirable employee behaviour (Otley and Pierce, 1996b; Pierce and Sweeney, 2006). One of two things could happen in response to this time pressure; either employees could cut corners and ‘sign off’ on incomplete jobs, or alternatively (as we find) all of the necessary checks are completed with due diligence, but the time taken on the job is mis-recorded.

Our case study is a large multinational accounting firm which operates three lines of service: advisory, audit/assurance and taxation. The firm operates on a regional basis in the UK with a regional chairman overseeing all activities.
The use and consequences of performance management and control systems: a study of a professional services firm for a particular region. Our research was carried out in a single regional branch of the organisation with all levels of employee being invited to participate in our survey.

The organisation has distinct hierarchical levels; support staff which provide the base administrative support, then the line of authority moves up from an associate (graduate entry level) to an executive, then to manager, senior manager, director, and ultimately onto partner. However, partners were eventually excluded from our survey for reasons of confidentiality (the findings section discusses the respondents to our survey).

Research method
The research method used is a web based questionnaire survey to investigate the perceptions of employees on performance targets and style of appraisal at the case study firm. The design of the initial questionnaire was based upon a framework of questions originating from prior research. In negotiation with the human capital section of the organisation, the questionnaire was re-designed to incorporate aspects that the firm was interested in finding out more about. Following some minor changes after feedback from a pilot study in the organisation, the anonymous questionnaire was conducted with all employees in a UK regional office. The survey was made accessible to approximately 1,250 employees via a web link on a region-wide email from the regional chairman. This web-based survey enabled employees more flexibility in the exact timing of when they chose to complete the questionnaire and this is likely to have increased the likelihood that employees would participate.

Through this study we aimed to investigate the use of targets and impact of targets on employee behaviour at all hierarchical levels in the organisation. Our study broadly expected to find the following:

- An increase in the level of employees’ dysfunctional behaviour as the relative importance of targets in performance appraisal increases.
- A greater reliance on financial information in target setting at managerial levels than at lower organisational levels, resulting in different styles of performance appraisal and assessment at different hierarchical levels.

Any incomplete responses were removed from our sample, leaving 236 usable observations for our analysis (this represents 19% of the total employees for the particular region surveyed). The data used in this study is derived from the questionnaire responses received. The data was then analysed using a series of regression based techniques to investigate our hypotheses. In the interests of brevity, discussion of research model estimation methods and techniques are kept to a minimum in this executive summary, although full discussion may be found in Ururuka (2007).

Findings

Respondent demographics
Just over half of the respondents to our survey were male and 65% of all respondents were aged between 26 and 40 (see table 1, panel A). The distribution of employment tenure of respondents suggests we captured a wide cross-section of employees in the organisation; 25.4% being employed for less than two years, 19.5% employed between two to four years, 17.8% employed between four and six years, and 37.3% employed for over 6 years (see table 1, panel B).

<table>
<thead>
<tr>
<th>Panel A: Age of Respondent by category</th>
<th>Number of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>25 years or less</td>
<td>47</td>
</tr>
<tr>
<td>26 - 40 years</td>
<td>153</td>
</tr>
<tr>
<td>Over 40 years</td>
<td>36</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: Employment tenure of respondent by category</th>
<th>Number of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>under 2 years</td>
<td>60</td>
</tr>
<tr>
<td>2 - 4 years</td>
<td>46</td>
</tr>
<tr>
<td>4 - 6 years</td>
<td>42</td>
</tr>
<tr>
<td>Over 6 years</td>
<td>88</td>
</tr>
</tbody>
</table>

Results

The use of financial versus non-financial targets
Our study asked respondents to assess the importance of financial targets they are set in their particular job. Consistent with expectations, the research suggests that the relative emphasis on financial targets changes with hierarchical level. As is shown in figure 1, lower level employees have fewer financial targets, as would be expected as their role is concerned with completing tasks on time, rather than an overview of financial performance of the...
The use and consequences of performance management and control systems: a study of a professional services firm

organisation. Directors have a higher percentage of financial targets than any other hierarchical level.

**Figure 1.** Percentage of targets which are financially oriented at our case company by hierarchical level

*Source: Ururuka (2007)*

Note: Respondents were asked to give the percentage of financially oriented targets in their role

**Performance assessment and focus on targets**

Much of the work completed at this firm is team based and therefore, an individual could be involved in more than one project team with different team leaders for each team. Feedback on the individual’s performance at the end of the task is provided by each team leader, as well as from peers and subordinates. From this feedback and comparison of performance to targets agreed with the employee a year in advance, a counsellor is assigned to combine all of the feedback for a particular employee and decide on a preliminary performance rating. The eventual performance rating awarded to an individual is based upon discussion between the counsellor and the unit leader, partners and business unit leaders before being confirmed to the employee by the counsellor.

We asked respondents a series of questions relating to their perception of their most recent appraisal investigating: (i) how much quantitative information was used in the assessment, (ii) the extent to which the appraiser was willing to accept explanations for lower than expected achievement levels; and (iii) the importance of short-term relative to long-term goals. To assess the level of ‘target focus’ in the performance appraisal process, we combine the set of responses into one variable which is termed the Performance Evaluative Style (PES) using structural equation modelling. A highly target focused PES would be expected to exhibit the following characteristics:

- use mainly quantitative criteria for assessing performance
- be unwilling to accept explanations for lower than expected performance levels
- focus on short-term performance
- only award a bonus to the employee if targets are met.

A PES with a low target focus would take target achievement into account in assessment of performance, but be willing to accept explanations for non-achievement of targets (providing it appeared that the employee had acted in the firm’s best interests). The level of target focus in PES of appraisers differs by hierarchical level, as may be seen from figure 2. It is apparent that more senior levels in the hierarchy have performance appraisers with PESs which are less target focused.

**Figure 2: Level of target focus in the performance evaluative style of appraisers at our case company by hierarchical level**

*Source: Ururuka (2007)*

For respondents with an appraiser with a high target focused PES, we find considerable disincentive effects of this type of performance appraisal. These respondents indicated a higher intention to leave the organisation and/or undesirable behaviour, such as skipping a required procedure or doing something which improves short-term performance at the expense of long-term performance (for detailed analysis of undesirable behaviour see Ururuka et al. 2009). These disincentive effects are found to arise, irrespective of whether the targets used are predominantly financial or non-financially focused (Ururuka 2007).

---

1 Target focus is measured on a scale of 1 – 7 where 7 is very highly target focussed performance evaluative style. This measure of performance evaluative style is the TF1 measure which is derived from six questionnaire items.
appropriate level of challenge in assigned targets

Counsellors negotiate targets with individual employees for the next 12 months in advance. This is likely to be motivational for employees as it makes them feel involved in the target setting process. In addition, if these targets are accepted by the individual and perceived as achievable, they are likely to view them as a clear goal which they will strive to achieve. Actual performance will be assessed relative to these targets, although managers may have a different perception from junior employees regarding the level of difficulty associated with the target (Beekes et al., 2007). We assess the level of challenge in, and individual commitment to assigned goals, through a series of question responses. Our results suggest, on average, employees at this firm are highly committed to their goals (average score of 5.31) and their goals are generally considered to be of an appropriate standard (average score of 3.97).

Using statistical techniques to investigate the relationship between the level of challenge in set targets, PES, and employee behaviour and performance, we find PES is very influential in determining performance and behavioural outcomes. Irrespective of the level of challenge in the target perceived by the individual (i.e. how difficult the target is), an excessive focus on targets in performance assessment was found to adversely affect employee behaviour and actual performance ratings achieved. This suggests it is how targets are used that is of paramount importance, rather than the level of the actual target set per se, although very challenging targets were also associated with dysfunctional behaviour (Ururuka et al, 2009).

mitigating adverse effects of targets

Our research found evidence to suggest some factors such as an interactive management style and high levels of trust help mitigate the negative impact of targets’ use in performance appraisal on employee behaviour. We asked respondents about whether the discussions they had with their appraiser focused on divergence from set targets, or on performance and development for the future. Our findings show that when supervisors have a more interactive approach to management, it is associated with greater amounts of employee effort, increased commitment to the organisation, and lower dysfunctional behaviour. Similarly, we find that when supervisors have high levels of their subordinates’ trust, this is associated with greater subordinates’ commitment to the organisation and to achieving performance targets, and lower dysfunctional behaviour. We also find that even when the supervisor focuses on targets in assessing subordinates’ performance, subordinates’ intentions to leave the firm are lower if the supervisor uses a more interactive management style than otherwise (see figure 3), and also if he/she is highly trusted by the subordinates (see figure 4).

Figure 3: Relationship between target focused performance evaluative style and intention to leave firm at low and high levels of interactive management style

Source: Ururuka (2007)

Figure 4: Relationship between target focused performance evaluative style and intention to leave firm at low and high levels of trust

Source: Ururuka (2007)

1 Scale of 1 to 7 where 1 is strongly disagree and 7 is strongly agree.
Managers’ performance levels

The average actual performance rating was 3.49 across all respondents on a scale of one to five where five is exceptional performance. However, we also asked the managers in the organisation to assess their performance relative to their peers (scale one to seven). In terms of their performance relative to peers an average score was 5.21, suggesting most managers perceive their performance to be above average relative to other managers.

Examination of our data revealed that the level of challenge in targets was important in determining performance of managers. When the achievement of targets formed a large part of performance assessment for a particular manager, managers’ performance decreased with target difficulty (i.e. when more challenging targets were set to benchmark the performance managers became de-motivated and underachieved, Ururuka 2007). Our results also show that managers whose performance was assessed against very challenging targets reported a greater intention to leave the organisation in the near future. This type of behaviour would be expected when individuals feel that they are being assessed against unfair benchmarks. Therefore, the level of target difficulty is not the focus in performance managers for managers. It is the level of target difficulty (and perceived difficulty by the manager) that determines eventual performance, although the level of focus on target achievement in performance appraisal is still an important factor. To maximise the performance of managers in the organisation, targets must be perceived to be achievable.

Conclusions and implications of findings

Our study of performance evaluative systems in a large UK accounting firm found that there are both non-financial and financial targets in use. The number of financial targets varies by hierarchical level, with predominantly financial targets being used at senior levels in the organisation. An excessive amount of focus on target achievement in performance appraisal was found to be associated with higher levels of undesirable employee behaviour, although more interactive styles of management reduced this undesirable behaviour. The findings suggest a number of ways in which performance measurement and management in organisations may be improved:

- Targets are a useful means to motivate and assess the performance of employees in the organisation. However, an excessive focus on targets in the organisation’s performance evaluations may have a de-motivational impact on employee behaviour. There is no difference between financial and non-financial targets in this respect. This could suggest that the move towards non-financial targets in organisations in itself is not going to be effective at reducing the negative impacts of targets on employee behaviour.

- Both the level of interaction with, and trust in, superiors were found to be important factors in mitigating the negative impact of targets on employee behaviour caused by a heavy emphasis on targets in performance appraisal. Creating a working environment that engenders greater trust amongst colleagues at all levels is important for employee motivation. To avoid ‘letting their managers down’, employees who are more committed to the targets set are likely to work harder to achieve the desired performance level. Consequently, better overall employee performance results from this interaction. Managers should therefore take time to nurture a relationship of trust amongst their subordinates, as this may have benefits in terms of employee performance and achievement levels.

- It is important to pitch targets at an appropriate level of challenge. If targets are perceived to be unreachable, this results in undesirable behaviour (for example, taking undesirable actions to meet budget targets). To maximise the performance from senior managers, targets should be perceived to be achievable. Targets which are accepted by managers as their own tend to be strived for, and greater overall performance is achieved as a result.

Where 1 was performance well below average, and 7 was performance well above average.
References


Further reading


Researchers' contact details

Dr Wendy Beekes
Department of Accounting and Finance,
Lancaster University Management School,
Lancaster, LA1 4YX
T. 01524 593623 F. 01524 847321

Professor David Otley
Department of Accounting and Finance,
Lancaster University Management School,
Lancaster, LA1 4YX
T. 01524 593636 F. 01524 847321

Dr Valentine Ururuka
Department of Accounting and Finance,
Lancaster University Management School,
Lancaster, LA1 4YX
T. 01524 592221 F. 01524 847321