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# Financial and non-financial performance measurement system on managerial performance through prosedural fairness and trust in superiors in manufacturing companies in Indonesia

**Anton Arisman[1]✉, Kathryn Sugara[2], Yulizar Kasih[3], Usniawati Keristin[4]**
MDP University

**Abstract**

The purpose of this study is to investigate the effect of Financial and Non-Financial Performance Measurement System on Managerial Performance through Prosedural fairness and Trust in Superiors in Manufacturing Companies in Indonesia The data used in this study is primary data with a sample about 153 respondents. The results of this study indicate the financial performance measurement system and non-financial performance measurement system have a positive affect on procedural fairness. However, financial performance measurement system does not affect on trust in superior. The financial performance measurement system also does not significantly affect on trust in superior. However, non-financial performance measurement system has effect on trust in superior. The financial performance measurement system and non-financial performance measurement system have a positive effect on managerial performance. The limitation of this study has low $R^2$ and doing the survey. The suggestion for future research can more investigate with other variables such as role clarity, role conflict, interpersonal trust and psychological empowerment. The last suggestion for future research is the qualitative method in their research, such as interview and case study.

**Key words:** Financial and non-financial; performance measurement system; managerial performance; prosedural fairness; trust in superiors



✉ Corresponding Author
Email Address: ariman@mdp.ac.id
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## INTRODUCTION

The company's organizational performance is largely influenced by the performance of employees, especially managers. A performance measurement system is needed that can provide managers with relevant information for strategic decision making. Performance measurement is one of the important factors for the company. These measurements can be used to assess the success of the company. The company's performance measurement so far has only focused on the aspect of financial measurement, whereas apart from this aspect of financial measurement, there are other things, namely non-financial performance measurement. Non-financial performance measurement is believed to be able to complement the features of short-term financial performance measurement and as an indicator of long-term performance (Kaplan and Norton, 1996). Performance measurement has an effected on employee compensation and rewards (Kaplan and Atkinson, 1998; Horngren et al., 2002); employees tend to pay attention to the performance appraisal process including the type of measurement used to evaluate their performance.

Previous research has shown the weaknesses of performance measurement systems to evaluate managers' performance (Johson and Kaplan, 1987; Kaplan and Norton, 1996a, Olve, Roy and Wetter, 1999). Thus, a new concept of performance measurement system emerged to cover the weaknesses of the traditional system (Kaplan and Norton, 1992; Otley, 2001). For example activity based costing, and activity based budgeting.

The performance measurement system itself can be concluded that there are two types, namely the traditional performance measurement system which only focuses on finance. The performance measurement system which is a combination of financial and non-financial performance measurement systems (Balanced Scorecard, BSC). This is due to the fact that the Balanced Scorecard has been used by many companies around the world (Malina and Selto, 2001).

Based on research by Ittner and Larcker (2003) there are several advantages of using non-financial measurements. First, managers can obtain business progress information from the company before the financial statements are published. Second, employees can obtain information from superiors about the behaviors needed to achieve strategic goals. Third, investors can receive more accurate information about the overall performance of the company since the use of non-financial measures that reflect intangible values, for example the productivity of the research and development department.

Performance measurement is the object of research in this study because there is increasing attention to the behavioral consequences of the type of performance measurement used in organizations. Financial performance measurement is more aggregated and only one-dimensional so that performance measurement is a narrow focus (Kaplan 1984; Lynch and Cross 1991; Ittner and Larcker 1998). In contrast, non-financial measures are concerned with customers, internal business processes, learning and growth perspectives and usually have a broader emphasis on future and long-term goals and are used for building and maintaining competitive advantage (Kaplan 1983; Kaplan and Atkinson 1998). Based on Kaplan and Atkinson (1998, p. 379) revealed that organizational investment in acquiring new capabilities, success or failure cannot be motivated only in the short term with the financial accounting model. The use of Balanced Scorecards introduces the driving force of future financial measurement. Thus, long-term non-financial measures result in more positive employee behavior than the use of short-term financial measures.

This study examines the relationship between the performance measurement system and the manager's performance; in this case, the performance measurement system is treated separately between financial and non-financial. Furthermore, the performance measurement system variable affects the managerial performance variable through two intervening variables, namely procedural justice and trust in superiors. Where previously no one has conducted research using performance measurement system variables that are separated based on financial and non-financial (Lau 2011)

This research will refer to research from Lau (2011) and develop the research model. Lau's research (2011) examines the relationship between non-financial and financial measurements on managerial performance through role clarity. This study will investigate further with the addition of two additional variables, namely procedural fairness and trust in superiors (trust in supervisors) or individual trust (interpersonal trust). Lau (2011) provides suggestions for future research with mediating variables such as fairness, trust. Satisfaction and organizational commitment.

The reason why it is necessary to conduct further research relates to trust in supervisors. Handerson (1980) suggested that to carry out successful performance measurement, it is necessary to build an environment in which employee trust from the organization. Merlinger (1956) and Read (1962) stated that fairness is important in measuring performance because an increase in trust between members in an organization leads to an increase in communication. Furthermore, in an environment of mutual trust, people in it will feel free from each other and open to members of the organization (Reina and Reina, 1999). Previous research (Hopwood, 1972; Lau and Buckland, 2001; Otley, 1978; Ross, 1994; Lau and Sholihin, 2005; Sholihin, Na'im and Lau 2004) examined the role of trust in performance evaluation of financial and non-financial measures. Previous researchers found that trust is a contributing factor in influencing the relationship between the type of performance measurement and managerial attitudes and behavior. Thus, this study will investigate further with regard to trust in superiors.

## Literature Review

### Goal Setting Theory

The goal setting theory assumes that a person's individual goals consciously influence motivation through one of the following four mechanisms, namely goals build effort to achieve goals, goals direct attention and effort toward goals, goals increase persistence to strive, and goals influence action directly by encouraging the use of knowledge with tasks and strategies (Locke and Latham, 2002; Bimberg, Luft and Shields, 2006). Goal setting theory indicates that a person will be motivated to make an effort when a goal is to be achieved (Locke, Shaw, Saari and Latham, 1981; Locke and Latham, 2002). Goal setting theory explains that goal setting not only affects work, but also motivates employees to seek or use the most effective work methods.

### Procedural Fairness Theory

Procedural justice focuses on the process or justice means used to reach decisions (Greenberg, 1987). Laventhal (1976), procedural fairness theory can be described as a development of equity theory that has been applied to the power of allocation process (Greenberg, 1987). Laventhal (1980) stated that procedural justice refer to the fairness of the process that results in the outcome of the decision.

Folger (1987) found that both procedural justice and distributive justice were independently related to behavior through decisions and organizations. However, fairness researchers believe that procedural fairness will result in more positive behavior despite the feeling of fairness of the decision (Korsgaard and Roberson, 1995). Therefore, procedural fairness can increase positive behavior through decisions.

### Financial and non-financial performance measurement system

The performance measurement system is the first step in the performance appraisal process, where the performance appraisal process is a means for management to find out the extent to which the company's goals or objectives have been achieved and also to see the achievements of business units, divisions, managers and employees in the company as well as to predict achievers who will become targets in the future (Mulyadi 2001). Performance measurement used to assess performance depends on how the business unit, division, manager or employee will assessed and how the goals will achieved by taking into account profits and costs as well as other matters related to performance (Morse, Davis and Hargreaves. (2000).

In general, the measurement of the company's organizational performance is only emphasized from a financial point of view, this eliminates another point of view, namely the measurement of non-financial performance. Non-financial performance measurement is believed to be used to complement the short-term financial performance measurement figures and as long-term performance indicators (Kaplan and Norton, 1996). Examples of non-financial performance measurements are customer satisfaction surveys, market share measurements, inventory loss levels and employee satisfaction surveys.

### Managerial Performance

The success of an organization in achieving its goals and fulfilling its social responsibilities, largely depends on its managers. If managers are able to carry out their duties well, the organization will be able to achieve the desired goals and objectives. How well a manager performs his role in carrying out tasks is a major issue debated in recent research.

This study defines managerial performance as the ability of managers to carry out managerial activities between planning, investigation, coordination, supervision, staffing, negotiation, and representation (Mahoney et al, 1963). The performance measurement system is affect the work of managers, which in this case is managerial performance. Someone who holds a managerial position is expected to be able to produce a high managerial performance. In contrast to employee performance in general, which is concrete, managerial performance is abstract and complex (Hall, 2008).

**The hypotheses development**

**Financial performance measurement system and non-financial performance measurement system and Procedural fairness**

The perceived fairness of the performance evaluation process is considered fair to all aspects of the organizational processes and procedures used by superiors to evaluate the performance of their subordinates, communicate performance feedback and determine their rewards such as promotions and salary increases (Lind and Tyler, 1988; McFarlin and Sweeney, 1992). Since the types of performance measures used and how these measurements are used are important aspects of the performance evaluation process, tend to influence subordinates' perceptions of fairness in the performance evaluation process.

The application of non-financial performance measures may be perceived by subordinates fairly. Non-financial measures are broad and varied. A variety of non-financial measures generally exist to suit the subordinate's operating environment. Therefore, subordinates tend to view this measurement as more meaningful and relevant. Furthermore, because non-financial measurement-based performance evaluation views the performance of subordinates in a broad range, it fulfills different dimensions of subordinate completion to be given due recognition in the evaluation process (Lau Sholihin, 2005). Performance evaluations tend to be viewed by subordinates as fairer than others, depending on only one aspect or dimension of performance. Based on Kaplan and Norton (1992, 1996), this performance evaluation considers both lagging and leading indicators, short-term and long-term goals, external and internal measurements of critical business processes, innovation and learning and growth, and the measurement of results – the results of past efforts – and future performance. For example, subordinates who pursue long-term goals such as product development and innovation, and whose performance is evaluated by the success of activities, tend to be considered fair evaluation processes. This suggestion is adopted from various non-financial performance measures of performance evaluations that are associated with perceptions of increased fairness in the performance evaluation process.

H1. Financial performance measurement systems has a positive effect on Procedural fairness.
H2. Non Financial performance measurement system has a positive effect on procedural fairness.

**Financial performance measurement system and non-financial performance measurement system and Trust in Superior**

Trust is conceptually as trust in superiors in this study. This variable has attracted much attention from management accounting researchers (eg, Hopwood, 1972; Otley, 1978; Ross, 1994; Lau and Buckland, 2001). Hopwood (1972, p.163) provides an understanding (concept) of trust in superiors as one of the dimensions in the relationship with superiors. Otley (1978) and Ross (1994) both have the same concept of individual trust as a subordinate (part) of trust in superiors. This study uses an instrument from the concept of Read (1962) the concept of trust as an instrument. Read (1962) expressed trust as a subordinate's belief or belief in motives and intentions with respect concerning issues relevant to the subordinate's career and status in the organization. Read (1962) noted that trusting subordinates expect their superiors’ interests to be protected and promoted, feel confident about disclosing negative personal information, feel confident about fully and frankly sharing information, and are prepared to see violated trust relationships.

An organizational performance measurement system tends to affect the trust of subordinates with superiors. Whitener et al (1998) argue that performance evaluation and reward systems can facilitate or hinder managerial trustworthiness behavior, and conversely, can affect subordinates' trust in superiors. Zand (1997, p. 118) suggests that a collaborative, integrative, and “win-win” organizational reward system tends to promote individual trust. Therefore, it is important for the organization to design a performance measurement system that might increase the trust of subordinates in superiors.

Performance measurement based on various non-financial measures tends to promote subordinates' trust in superiors. Hopwood (1972, p.176) reveals that too few and too rigid performance measures can lead to a “climate of distrust” because subordinates tend to be less satisfied with superiors whose p-processing of this type of measurement threatens (their) security. Conversely, if measures based on multiple nonfinancial measures are used, subordinates may be evaluated as a good overall measure, although some performance measures may not be good. In situations like this, subordinates tend to view performance measurement favorably.. Whitener et al (1998) suggest that an important criterion of superior behavior is benevolence or demonstration of concern, showing consideration of the needs and interests of subordinates, acting in a way that protects the interests of subordinates and the repeated exploitation of subordinates. Therefore, if subordinates feel that their superiors act generously, their trust through their superiors is also likely to increase. Empirically, both Hopwood (1972) and Otley (1978) found that performance measurement based on non-accounting measures was associated with high trust in superiors. Thus, there is a positive relationship between the use of performance measurements based on non-financial measurements and the trust of subordinates to superiors.

H3. Financial performance measurement system has effect on Trust in superior.

H4. Non Financial performance measurement system has effect on Trust in superior.

**Trust in superiors, managerial performance**

Participation in the establishment of performance measurement will increase the level of trust between the parties involved in the performance measurement process. In this regard, previous research states that trust is an important factor in the performance measurement process (Lau and Sholihin, 2005). However, none of the previous studies examined the effect of trust in the performance measurement process on managerial performance. Thus it can be concluded that if division managers/unit managers trust their senior managers with their performance measurement to evaluate their managerial performance. The stronger the level of trust between the parties involved in the performance measurement process, the better the unit’s managerial/divisional manager performance of the unit. The proposed hypothesis is as follows:

H5. Trust in superiors has a positive effect on managerial performance

**Financial performance measurement system and non-financial performance measurement system on managerial performance.**

The same situation applies to the relationship between non-financial measures and financial measures on managerial performance. This situation satisfies the conditions of the mediation function as determined by Baron and Kenny (1986). Therefore, we propose a direct relationship between Non-Financial and Financial Performance Measurement Systems, with managerial performance, the hypothesis is as follows;

H6. Non-financial measures have a direct relationship with managerial performance.

H7. Financial measures have a direct relationship with managerial performance.

## METHOD

**Research design**

The survey is to examine the relationship between the performance measurement system and managerial performance through two intervening variables, namely procedural justice, trust in superiors. To test the model in this relationship, a survey questionnaire used which is sent to responsibility center managers in manufacturing companies listed on the Indonesia Stock Exchange.

**Data collection technique**

The data used in this study is primary data, namely the respondents' answers to the questions on the research questionnaire. The questionnaires sent by email and online survey.

**Measurement Variable**

Measurement of financial and non-financial performance is measured based on the instruments obtained from Scott and Tiessen (1999), Kaplan and Atkinson (1998) and Hopwood (1972). The statement from the instrument that was asked to the respondent was when the supervisor evaluates the performance, how important it is according to them based on the things that are used as the instrument.

Measurement of financial performance from Scott and Tiessen (1999) with the instrument whether it is necessary or a better cost budget; the ability to achieve reduced cost budgets, and the ability to achieve or better sales budgets or sales growth targets. Non-financial measurement is based on the performance measurement suggested by Kaplan and Atkinson (1998) for the Balanced Scorecard.Thus it can be concluded, the instrument for financial measurement is 4 items and for non-financial performance measurement is 5 items. The scale used is from 1 “not important”: to 7 “always important”.

Fairness in performance measurement procedures. The instrument developed by McFarlin and Sweeney (1992) is used to measure fairness in performance measurement procedures. This instrument consists of four items, which ask respondents to rate the fairness of the procedures used to evaluate their performance, to communicate performance feedback, and to determine salary increases and promotions.

The level of trust of subordinates towards superiors is measured using an instrument developed by Read (1962) and later used by Hopwood (1972), Otley (1978), and Ross (1994).

The managerial performance measurement scale in this study is a nine-measurement scale adapted from Mahoney, et al (1965) with 8 statements. The scale used is a seven-digit Likert scale, namely from (1 for very low to 7 for very good). The measurement scale of Mahoney et al (1965) has been used by previous studies, namely Otley and Pollanen, 2000; Chong and Chong, 2002; Wentzel, 2002; Marginson and Ogden, 2005; Parker and Kyj, 2006 and Hall, 2008, 2011).

**Analysis Method**

The data analysis used Structural Equation Model with Partial Least square. This study uses the partial least square.

## RESULT AND DISCUSSION

**Table 1.**
The Data of Respondents in this study

| Description | | Total | Percentage (%) |
|---|---|---|---|
| Gender | Male | 95 | 62,09 |
| | Female | 58 | 37,91 |
| Age | 30– 40 years | 74 | 48,36 |
| | 41 - 50 years | 57 | 37.25 |
| | >51 | 22 | 14.37 |
| Education Level | Bachelor | 116 | 75.82 |
| | Master | 37 | 24,18 |
| | Financial | 63 | 41,17 |
| | Human Resources | 19 | 12,4 |
| | General | 12 | 7.8 |
| | Marketing | 19 | 5.2 |
| | Production | 24 | 15,68 |
| | Other | 16 | 10,5 |

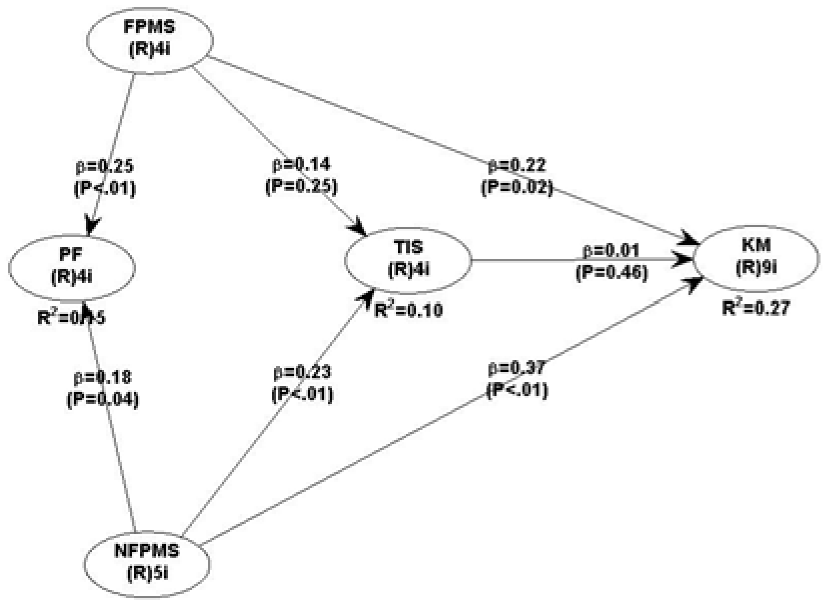


**Figure 1.**
The result from Partial Least Square

**Table 2.**
The result of hypothesis

| Hypothesis | β | P value | Result |
|---|---|---|---|
| FPMS → PF (H1) | 0,25 | < 0,01 | Supported |
| NFPMS → PF (H2) | 0,18 | 0,04 | Supported |
| FPMS → TIS (H3) | 0.14 | 0.25 | Rejected |
| NFPMS → TIS (H4) | 0.23 | < 0,01 | Supported |
| TIS → MP (H5) | 0.01 | 0.46 | Rejected |
| FPMS → MP (H6) | 0,22 | 0,02 | Supported |
| NFPMS → MP (H7) | 0,37 | < 0,01 | Supported |

Note:
FPMS = Financial Performance Measurement System;
NFPMS = Non-Financial Performance Measurement System;
PF = Procedural fairness;
TIS = Trust in Superior; and
MP = Managerial Performance

Based on figure 1 and table 2, the hypothesis 1 has the value of the path coefficient (β) on the effect of FPMS → PF is 0.25, the p-value is 0.01. This means that hypothesis 1 (H1) is supported, because p value less than 0.05. Financial performance measurement system has effect on procedural fairness. The second hypothesis (NFPMS → PF) has the p value is 0.04 (less than 0.05) and the path coefficient value is 0.18, which reveal that the second hypothesis is accepted. The non-financial performance measurement system has a positive effect on procedural fairness. The third hypothesis, FPMS → TIS, has the p value is 0.025 and value of path coefficient about 0.14. The third hypothesis is rejected. The Financial performance measurement system does not have effect on trust in superior. The fourth hypothesis (NFPMS → TIS) is supported, because the path coeffient value is 0.23 and p value is 0.01. The fourth hypothesis is supported. The non-financial performance measurement system has effect on trust in superior. The fifth hypothesis, TIS→ MP, has the p value 0.46 and the path coefficient value is 0.01 which revels this hypothesis is not supported. The trust in superior has not effect on managerial performance. The sixth hypothesis has the path coefficient value is 0.22 and p value is 0.02 (FPMS → MP). The sixth hypothesis is supported, which reveals that Financial performance measurement system has effect on managerial performance. The final hypothesis, NFPMS → MP, has p value is 0.01 and the path coefficient value is 0.37. The final hypothesis is supported. The non-financial performance measurement system has effect on managerial performance. The findings support the goal setting theory and procedural fairness theory.

## CONCLUSION

The financial performance measurement system and non-financial performance measurement system have a positive effect on procedural fairness. However financial performance measurement system does not effect on trust in superior. The financial performance measurement system also does not affect significantly on trust in superior. However, non-financial performance measurement system has effect on trust in superior. The financial performance measurement system and non-financial performance measurement system have a positive effect on managerial performance. The findings of this study support the goal setting theory and procedural fairness theory.

The limitation of this study has low $R^2$ and doing survey. The suggestion for future research can more investigate with other variables such as role clarity, role conflict, interpersonal trust and psychological empowerment. The last suggestion for future research is qualitative method in their research such as interview and case study.

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