Performance measures

Finance

Performance Measures Investment centers have varied performance measurements. One of them is the return on investment, ROI. This most common type of performance measure considers both the operating income and the invested assets to give the income earned into an account as documented by Needles, Powers and Crosson (2014). Higher ROI means that the investment center utilized a small portion of the invested assets to generate greater operating income as opposed to lower ROI which would mean that more invested assets were used to generate a similar or lower operating income. Despite encouraging a comparison of income generated to assets used, Caplan (2014) argues that this measurement could encourage focus on short-term as opposed to long term financial performance and deferment of asset replacement.

The second measure is residual income, RI. RI refers to the operating income earned by an investment center above the minimum desired return on the assets invested (Needles et al., 2014). This is a dollar amount of profit that remains after the subtraction of the targeted income for an investment center. RI is a significant measure because it enhances goal congruence (Jiambalvo, 2011). This follows the fact that RI encourages managers to invest so as to post higher RI values.

Of these two performance measurements, RI would be considered as more important. Whereas both measures determine performance, RI incorporates the rate of return that an organization expects from invested capital (Needles et al., 2014). Thus, any investment with a return exceeding the minimum needed rate of return yields a positive RI. As such, RI measures an important aspect of performance, the level of investment, which ROI omits, making it a more important measure of performance.

References

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