Preface

There is little dispute that one of the core purposes of both entrepreneurship and strategic management theory and research is the improvement of organizational financial performance (Venkatraman and Ramanujam 1986; Eisenhardt and Zbaracki 1992). However, there seems to be no consensus regarding the best, or even sufficient, measures of organizational performance. This is in no small part due to the many varied views on the most desirable outcomes of organizational effectiveness and because performance has often been characterized by the theory and purposes of the research being performed. Researchers further confound the problem by confusing determinants of performance with measures of performance (Cameron 1986).

In this book, we seek to develop an improved measure of overall organizational performance in order to provide entrepreneurship and strategic management researchers and managers with a better understanding of the implications of selecting variables for use in empirical studies and practice where overall organizational financial performance is the criterion of interest. The paradox of management research, as expressed by Cameron (ibid.), is that empirical studies tend to explain average performance, while the focus should be on understanding what makes firms either successful or unsuccessful. By developing better measures of overall organizational financial performance, researchers and managers should be able to better differentiate firms that are performing well, from those that are performing poorly.

Specifically for management practice, providing a greater understanding of which dimensions of performance covary with shareholder returns permits better strategic focus in for-profit companies. This information may allow management to track critical financial performance metrics that anticipate market reactions where actual market valuations are unavailable, such as for new ventures and privately held small and family-owned firms. Further, a better understanding of the relative and incremental information content of financial performance metrics can assist managers in selecting non-financial metrics to fill information gaps about overall organizational performance.

WHY ANOTHER BOOK ON FINANCIAL PERFORMANCE MEASUREMENT?

Measurement is the 'careful, deliberate, observations of the real world for the purpose of describing objects and events in terms of the attributes composing a variable' (Babbie 1998: 116). For a variable to be clearly and equally understood by many different individuals, it must be accurate, precise, quasi-invariant across observers, provide discrimination from other variables and be stable over time.

For entrepreneurship and strategic management scholars, the development of valid operationalizations of the key concepts and constructs used to form both independent and dependent variables in the models used in each field, is fundamental to the description and corroboration of theoretical relationships being tested in research, and is the essence of the measurement stream of research. In other words, the validity of research studies that use arbitrary dependent measures to represent overall organizational performance is highly questionable. Researchers need to know that the effects they are studying will reasonably be represented by the changes in the dependent variables. The use of different measures as proxies for 'performance' makes extension from one study to the next dubious.

WHAT IS COVERED IN THIS BOOK?

Four important questions are examined:

1. What is the 'essential' nature of overall organizational financial performance?
2. What are the primary constructs that represent the different dimensions underlying overall organizational financial performance?
3. What are the best measures of the primary constructs underlying overall organizational financial performance?
4. Can a model of overall organizational financial performance be developed that distinguishes between high- and low-performing companies?

These questions are important for several reasons. First, a multidimensional model of organizational performance has not been explicitly studied before. Second, a generalizable and more powerful measurement model of overall organizational performance could help resolve previously inconsistent research findings where different dependent variables were used to represent the same phenomenon. Third, understanding the relationship between the many different financial variables and the creation of shareholder value provides a better basis for understanding the quality of management decisions. Finally, a multidimensional model of overall organizational performance could significantly improve organizational stakeholders' understanding of the effectiveness of management. Such a model allows for the measurement of value creation and for reasonable comparison across companies that have chosen different paths to creating value.

The model developed in this research provides another tool for researchers to understand the simultaneous interaction of financial influences on the creation of shareholder value. Perhaps the most important contribution of the research is the development of a multidimensional composite measure that explains over five times the variance in market adjusted shareholder returns than the most frequently used variables in recent entrepreneurship and strategic management research.