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Hanna Pitkänen

Turku School of Economics, Finland

Kari Lukka

Turku School of Economics, Finland



Turun yliopisto
University of Turku

Formal and informal feedback in management accounting

Taking a look beyond the balanced scorecard

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Key conclusions:

- Formal and informal feedback plays a key part in influencing how effectively organisations are managed.
- Formal and informal feedback does not form a black and white dichotomy with strict boxes, but is a continuum with a grey area in between.
- The power of modern models, such as the Balanced Scorecard (BSC), to balance feedback is questionable and does not detract from the relevance of informal feedback.
- Viewing feedback along three dimensions: source, time, and rule – can help make sense of the various interpretations of formal and informal feedback in organisations.
- In large organisations, especially middle managers are key to keeping vertical chains of feedback going. The challenge is for managers not to rely solely on systems based, formal accounting feedback in decision making.

Executive summary

Most contemporary organisations and societies are faced with a common paradox: information systems are constantly improving and users are receiving more and more systems based information but still they suffer from the inability to get sufficient personal feedback. Why is this?

Drawing on a case study with interviews of twenty senior and middle managers in a large metal industry company, we call for a shift in focus from systems *per se* towards an increased use of feedback practices.

In management accounting, feedback has traditionally been viewed rather mechanistically - as a formal control loop between goals and measured performance using formal accounting and information systems, such as the balanced scorecard (BSC). We suggest feedback should be considered as a wider concept, one that includes many types of feedback flows, both formal and informal, which all influence how effectively organisations are managed towards common goals.

The subject of formal and informal feedback, in the context of management accounting, is broad and diverse. We therefore propose a three-dimensional framework as a tool for discussing different views on the subject.

Introduction

With the help of performance measures, managers receive and use feedback to assist organisations to achieve their goals, implement their strategies, and learn. Diagnostic control systems, like budgets and performance measures, aim to ensure predictable goal achievement with corrective feedback by comparing and calculating deviations between actual performance and preset goals or standards. Results from the output provide formal numerical feedback (output feedback) on how well an organisation is achieving its strategic, operational, and financial goals.

In management accounting, feedback has been studied mainly in the context of performance measures (i.e. formal feedback). Scorekeeping, attention-directing, diagnostic and interactive control systems are well-known examples of formal feedback. This discussion is based mainly on systems thinking and on cybernetic control theory. From a cybernetic viewpoint, feedback is regarded as a signal, a mechanism, and a process controlling the system within itself.

Already from the 1970's, management accounting literature has pointed out several limitations in formal systems' ability to produce relevant and adequate information:

it is untimely, unreliable, too general, or limited for managers. Since those times, the area of formal feedback in organisations has developed with more transparent and comparable information and management systems. The BSC by Kaplan and Norton (1992, 1996) has been marketed as a comprehensive, holistic, and multidimensional measurement framework. It aims to quantify processes and stresses the role of formal performance measures. While the balanced scorecard can be viewed to encompass informal feedback through new kinds of measures, it is unclear what the role of informal feedback is in organisations.

We therefore question whether a strong link between systems and contemporary feedback practices exists. Managers are not simply passive recipients of measured feedback - they also seek additional feedback actively. The ability to produce and use both formal and informal feedback efficiently depends on the skills and abilities of managers and the organisation's history and culture. Informal feedback is therefore an inherent part of feedback practices in organisations.

Conceptualising feedback

Theoretically, the concept of feedback as distinct from mere information requires goals, standards, or forecasts (explicit or implicit, organisational or personal) against which actions, operations, and changes in the environment can be compared (*ex post*) or evaluated (*ex post* or *ex ante*). Feedback can be analysed either at the:

- organisation level, focusing on output or
- person level, focusing on individual performance.

At the organisation level, output feedback can take the form of performance reports, organisation wide key performance indicators, or information about competitors' performance. At the person level, feedback is described in terms of behaviour, motivation, learning, and communication between superiors and subordinates.

In management accounting literature, feedback as a response to the variance between performance and goals can be viewed rather broadly:

Goal achievement

Feedback helps to control units by tracking their development. In case of observed deviations between preset goals and actual outputs, feedback is used to align actions with the intended level of performance.

Goal congruence

Feedback directs and motivates individual behaviour towards organisational goals. For example, in performance appraisal interviews, evaluative feedback from the manager as well as monetary and social rewards assist in working towards shared common goals.

Goal revision

Individuals and organisations use feedback to make changes and learn in order to improve their performance. Feedback helps to direct attention to relevant issues not only in the past but also in the future.

Goals can be also in the form of future forecasts. Although feedback is considered primarily an 'ex post' control device, it can be interpreted either in a narrow or broad sense having both backward directed and forward directed loops in terms of time. In the traditional narrow meaning, feedback is seen only as a backward directed comparative between actual performance and pre-set goals with deviations revealing the need for actions ('ex post' control with output feedback). From a broader viewpoint, feedback can also be considered

as future directed 'feed-forward' information, which can be used to forecast the need for actions before observed deviations occur in the environment ('ex ante' control with input feed-forward).

In practice, various kinds of feedback loops often operate simultaneously: for example, rolling budgets include both monitoring of actual outcomes ('ex post') as well as planning and future forecasts ('ex ante'). Therefore, we use the term feedback in accordance with the broad interpretation. Feedback loops, whether operating as 'ex post' or 'ex ante', may take place both formally and informally, even though formalising future directed processes are usually regarded as highly challenging.

Conceptualising formal and informal feedback

Earlier literature provides various interpretations of formal and informal feedback. We offer three dimensions – source, time, and rule (see figure 1) – as an analytical tool to make sense of the various interpretations of formal and informal feedback.

Figure 1. Different definitions of formal and informal feedback from the literature review

	Formal feedback	Informal feedback	Dimension
London (2003)	Formal appraisals, performance reviews, or meetings with superiors	Communicated in everyday interactions, individual feedback seeking behaviour	Source, Time, Rule
Lockett and Eggleton (1991)	Feedback provided through management accounting systems (MAS)	Provided through social sources such as superiors, peers, task, and self (person-to-person feedback)	Source
London and Smither (2002)	Provided through formal mechanisms	Provided independently of formal mechanisms	Source
	Planned, officially defined feedback	Unplanned or 'in the moment' feedback	Time, Rule
Katz and Kahn (1978)	Scheduled feedback	Unscheduled feedback	Time
Ashford and Tsui (1991, 253)	Requisite feedback (e.g. formal performance appraisal systems, formal measurement systems, and formal communication among managers)	Unsolicited feedback	Rule, Source

Source dimension. First, the literature distinguishes formal and informal feedback along pathways through which feedback flows. For example, formal feedback consists of formal performance reviews or meetings whereas informal feedback is communicated in everyday interactions or independently of formal mechanisms.

Time dimension. Formal feedback is planned beforehand and systematically scheduled into the official procedures of the organisation. Instead, the nature of informal feedback can be accentuated as taking place in everyday interactions, as an unplanned or spontaneous event, or 'in the moment' feedback.

Rule dimension. Formal feedback can be related to mandatory routines and communication derived from the hierarchical relationship between managers and units. Informal feedback is associated with unsolicited feedback, i.e. any feedback perceived to be voluntary by the managers.

Research settings and methods

Our research is based on a qualitative case study of Division Steelco, which is the oldest division out of four of a large, global firm operating in the metal industry. Data was collected mainly through twenty semi-structured thematic interviews, recorded and transcribed between September 2007 and February 2009. We interviewed senior and middle managers of Division Steelco's local operations in Finland and also a few senior managers from the corporate headquarters. This provided an overview of the general management system of the group as well as relations between the headquarters and Division Steelco's local units. Interviews were supported by analysis of official documents, internal records received from the interviewees, observations during the interviews, and in numerous informal situations, such as factory visits and lunches.

Flows of formal and informal feedback in management accounting

In previous management accounting literature, formal controls were typically seen as system-based structures, while informal controls were based on social structures that could be assumed to produce feedback. This is only a part of the story in our view:

Source of feedback

According to the widely used distinction in previous management accounting literature, accounting information systems and interpersonal communication are used to illustrate formal and informal feedback practices in organisations.

System-based feedback (formal) is linked to accounting and information systems. Performance data is codified into systems and can then be given and received without interpersonal communication. The formalisation of feedback sources assures a certain minimum level of feedback is given everywhere, which makes individual preferences and differences between managers less crucial.

Interpersonal feedback (informal) is given between two or more people allowing a broader scale of themes and questions to be dealt with. Examples of feedback practices that involve interpersonal feedback are; performance appraisal interviews, management group or team meetings, and other communication between managers, employees and peers. Feedback communicated in human interaction is linked to the people involved and the context. Therefore it may stay only at a local level and cannot be used more systematically in the whole organisation. One of the advantages is that it allows a broader scale of feedback loops, such as non-verbal communication and body language.

Thus, all feedback channels provide a variety of different elements of feedback - both formal and informal.

Timing of feedback

Time dimension is suitable for considering formal and informal feedback in relation to when certain flows of feedback operate.

Regular feedback (formal) in the form of ongoing reporting of results gives managers a comparable time series with which to follow trends and analyse the changes over time. The feedback is planned beforehand and operates systematically over certain periods. For example, key performance indicators are followed month after month or quarter after quarter.

Irregular feedback (informal) – a lot of feedback in everyday life is something that just emerges spontaneously in the moment or during action. Irregular feedback allows faster responses to changes and assists in daily management and real-time decision-making. For example, managers may ask for controllers to prepare an *ad hoc* report because of alarming changes in a certain market, product, or customer segment.

Rules of feedback

Rule dimension is suitable for considering formal and informal feedback in relation to why certain flows of feedback are provided.

Requisite feedback (formal) is based on coercive hierarchical communication between managers and employees, e.g. in the form of producing monthly

performance measures for the headquarters or standard procedures for performance appraisal interviews.

Unsolicited feedback (informal) is any feedback perceived as voluntary and additional. This is connected to personal abilities, styles, and preferences to offer and receive feedback. Managers' attitudes towards feedback practices affect the way additional feedback is given.

According to our empirical findings, the existence of a hierarchical relationship may transform informal ad hoc situations into formal feedback situations. This may occur, for example, when a manager asks an employee to discuss an emergent issue with them. Interestingly, the interpretation of formality seems to vary between manager and employee. Employees may regard daily discussions with their manager as formal, while managers regard them as informal. In the case of performance appraisal interviews, even this kind of rather formal manager-employee communication includes qualitative and personal evaluation. In addition, employees name managers as an important feedback channel whilst this is seen as less important for managers. Often individuals are primarily more interested in getting feedback from their managers than from their own employees.

Conclusions

Performance measurement systems producing ex post numbers are commonly described as formal feedback. Others see that much feedback emerges informally from 'the noise' of everyday actions. What comprises informal feedback is less specified, and is sometimes viewed simply as the opposite to formal management accounting system feedback. We analysed different interpretations of formal and informal feedback in management accounting along three dimensions: source, time, and rule.

At the beginning of our research we assumed that the area and content of informal feedback would be more broad and diverse than that of formal feedback. However, the previous discussion illustrates that not just the concept of informal feedback but also the concept of formal feedback has room for many interpretations.

Instead of strict dichotomies, the degree of formality in feedback operates on a continuum, specified by qualifiers like formal – semiformal – informal, or formal – less formal – more informal – informal. Further, it is constructed of different aspects, which are not exclusive of each other. People may choose to use informal feedback channels, like ad hoc face-to-face meetings, when discussing performance measures or give voluntary, additional feedback together with their monthly reports. We underline our view that

formal and informal feedback does not form a black and white dichotomy with strict boxes, but also incorporates a grey area between them.

We question the power of modern models, like the BSC, to balance feedback. The idea of the BSC is to widen formal feedback with non-financial and leading measures. Still, new measures alone do not bring balanced feedback or undermine the relevance of informal feedback. As the following quote states:

'We need more qualitative feedback. We have systems and electronic information, but the problem is that we should have more qualitative discussion. Communication should come off from the computer screen... we need more face-to-face communication and leadership. Nowadays people try to lead with the help of PCs.'

Senior vice president in human resources, Group

Both formal and informal feedback needs to be recognised in the organisational context in order for the theory of feedback to be full-scale. This framework includes both systems-feedback and the flows of more informal feedback, which until now have been discussed mainly in the confines of human resource management and leadership literature. Extending the understanding of the existence and usefulness of various feedback flows could assist individuals and organisations to work more efficiently towards common, acceptable goals and behaviour. Discussion, based on results, is also called for:

'In addition to taking a look at reports, subordinates may want to discuss the information... we should understand when the response 'okay' is not enough. Discussion is what they need. The problem is that time is limited and we should have more time for analysis and feedback in line with the management of results.'

Senior vice president, Steelco

The challenge in today's hectic business life is that managers do not settle solely for systems-based accounting feedback. In large organisations, especially middle managers are key to keeping vertical chains of feedback going. Their response to this challenge could be passive, in which case control is by receiving available, mainly formal feedback loops. However, control by seeking additional, mainly informal, feedback loops, requires active behaviour from managers.

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Authors:

Hanna Pitkänen

Kari Lukka

Turku School of Economics

Rehtorinpellonkatu 3, FI-20500 Turku, Finland

Email: Hanna.Pitkanen@tse.fi

Telephone: + 358 2 4814 326

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**Chartered Institute of
Management Accountants**

26 Chapter Street
London SW1P 4NP
United Kingdom

T. +44 (0)20 7663 5441

E. research@cimaglobal.com

www.cimaglobal.com

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