The association between ISO 9000 certification and financial performance

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Abstract

This study explores the association between ISO 9000 certification and financial performance at the organizational level in a mature quality initiative market. It extends the limited literature on quality initiatives and objective measures of financial performance. The study hypothesizes that ISO 9000 certification is associated with improvements across three dimensions of financial performance. These dimensions are operating efficiency, growth in sales, and overall financial performance. These dimensions of performance are measured using profit margin, growth in sales, and earnings per share, respectively. Based on data for a sample of 70 companies listed on the Singapore Stock Exchange over a 6-year period, the results of the study are consistent with the hypothesized effects. In particular, the results show that the extent of improvement is driven largely by operating efficiencies and suggests that firms can benefit from ISO 9000 certification if they are genuinely interested in the quality philosophy by improving their internal business processes.

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1. Introduction

Quality management initiatives such as total quality management (TQM) and just-in-time systems (JIT) are receiving growing attention in management accounting textbooks. However, the effect of such initiatives on financial performance has received little attention in academic research. This is probably because much of the research on quality and self-reported non-financial firm performance measures are located in the quality management paradigm. Noting the lack of studies on quality initiatives generally, Maher (1995) urged accounting researchers to undertake a time-series exploration of the effects of quality initiatives on organizational performance. However, such research remains scarce in the accounting discipline. Ittner and Larcker (1995) were among the first management accounting researchers to study the effect of quality management practices on organizational performance. Balakrishnan, Linsmeir, and Venkatachalam (1996) and Kinney and Wempe (2002) investigated the financial impact of JIT systems. Most recently, Nagar and Rajan (2001) studied the relationship between financial and non-financial indicators of quality and future sales.

However, it is not easy to establish an empirical relationship between the adoption of quality initiatives such as TQM and JIT and firm performance that are measured by accounting variables. The difficulty of establishing an empirical relationship between TQM and JIT initiatives on firm performance stems from determining the objectivity of the extent of adoption, the validity of the adoption claims by the firm, and identifying an adoption date. Easton and Jarrell (1998, p. 256) describe the problem in the context of TQM as follows:

First, whether or not a firm has seriously pursued TQM cannot be determined by relying on the firm’s public announcements. Many firms claim to be implementing TQM when, in fact, they have made essentially no changes (other than in their public rhetoric) . . . Second, firms seldom publicly announce the beginning of the deployment of their TQM systems. In fact, there is often no completely unambiguous start date.

The purpose of this research is to investigate the association between International Organization for Standardization 9000 (ISO 9000) certification and financial performance at the organizational level. A study of the effect of ISO 9000 certification on financial performance alleviates the limitations of prior studies because the certification process requires compliance with the elements of the ISO 9000 standards. The certification process is conducted by an approved independent ISO 9000 registrar. If a firm meets the ISO 9000 standards following an audit by a registrar, the firm is issued an ISO 9000 certificate that includes the scope of certification and the effective date. While certificates are typically issued for 3-year periods, compliance review is performed every 6 months.

Although ISO 9000 certification has been globally pursued and implemented, very few studies have explored its impact on objective measures of financial performance. The literature abounds with studies examining the effect of ISO 9000 certification on self-rated performance measures such as product quality, defects, employee satisfaction, employee turnover, customer satisfaction, supplier quality, and productivity, to name a few. While such studies add to our knowledge about the effects of ISO 9000 certification and quality
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